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Remarks:

Executive Secretary

5/3/82

Date

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DEPARTMENT OF STATE

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Executive Registry

82-4321/12

April 30, 1982

MEMORANDUM FOR:

Nancy Bearg Dyke
Assistant to the Vice President
for National Security Affairs

Michael Wheeler
Staff Secretary to the
National Security Council

David Pickford
Executive Secretary
Department of Treasury

Robert P. Meehan
Assistant for Interagency Matters
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Department of Agriculture

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William V. Vitale
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Department of Energy

William Schneider
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and International Affairs
Office of Management and Budget

Thomas B. Cormack, Executive Secretary
Central Intelligence Agency

Dennis Whitfield
Executive Assistant to the USTR

Roger Porter, Special Assistant to the
President for Policy Development

James Burnham, Special Assistant to the
Chairman, Council of Economic Advisers

Charles F. Stebbins, Executive Assistant
to the Chairman, Joint Chiefs of Staff

SUBJECT: Versailles Summit: Briefing Materials for President's Trip to France, June 4-6, 1982

It was agreed at the meeting of the Versailles SIG on April 28 that the Department of State would circulate all papers, as received from agencies, by COB April 29 for information. Attached are papers received and a list of papers not received. Comments on the papers should be directed in the first instance to the drafting agency's coordinator listed below.

State	Marshall Casse	632-1089
Treasury	Ralph Korp	566-5635
Defense	Steve Bryen	697-9347
Agriculture	Joanne Holdquist	382-1345
Commerce	John Paugh	377-5853
Energy	Carol Lee	252-6383
USTR	Gerza Feketekuty	395-3582
CEA	James Burnham	395-5084

L. Paul Bremer III
Executive Secretary

Attachments:
As stated.

PAPERS NOT RECEIVED	DRAFTING AGENCY
U.S. Economic Situation	CEA
Overview North/South Issues	State/NSC
Global Negotiations	State/NSC
MDB Issues -- Energy Affiliate	Treasury
CBI	USTR
Multilateral Food Corps	AID
Energy Security	NSC
High-Tech Trade Issues	USTR
R & D Investment	Commerce
International Aspects of High Tech	Commerce
Arms Control	State
Central America/Caribbean	State
Southern Africa	State
China (Contingency)	State
Bilateral Issues Papers have not been received for Japan, Italy and UK	State

VERSAILLES SUMMIT

June 4-6, 1982

SCOPE PAPER

U.S. OBJECTIVES

Theme

The President's central theme throughout the European trip will be to affirm shared Western values and the need to revitalize Western economic and military strength in support of these values. He will stress the importance of the alliance as a symbol of shared values, and as the key to the deterence of war. He will project himself as a strong leader committed to peace, prosperity and freedom.

Principal Objectives

Trade: To obtain a political commitment to (a) resolve problems facing the multilateral trading system without restoring to bilateralism or protectionist actions (b) extend the principles of free trade to new sectors (such as services, investment, high technology and agriculture) and cover a range of trade-distorting practices not traditionally subject to international discipline, (c) seek to include more fully new countries, such as the new industrializing countries in the free trade system, and (d) work for a productive GATT Ministerial this fall as an initial step in this direction.

East-West Economic Relations: To continue building a consensus on the need for Western solidarity in East-West economic relations, emphasizing the relationship between East-West trade and security issues by:

-- Securing endorsement of an agreement to restrict official credits and eliminate credit subsidies to the Soviet Union and to monitor credit flows to CMEA countries.

-- Endorsing strengthened COCOM, as agreed at the High-level Meeting, especially to restrict the flow of sensitive technologies to the USSR, by better enforcement and more effective COCOM operations.

Economic Revitalization: To confirm the necessity of reducing inflation, of promoting private sector activity, especially private investment, and of greater reliance on market signals as essential elements in revilatizing Western economies and to explore avenues for greater international economic cooperation, based on common long-term objectives, as an alternative to short-term measures that seek to evade market forces.

Supplementary objectives

- To initiate a process leading to a framework for international investment, similar to the GATT for trade in goods.

- To reiterate the importance of agricultural policy for developing, as presented at Cancun, and propose extending the "food teams" concept to a multilateral basis.

- To strengthen Western energy security, with particular attention to developing energy resources within the Western community.

- To initiate a multilateral program to build new ties among the next generation.

Setting

The Annual Economic Summit takes place on June 4-6 in Versailles, France. This Summit is the eighth and the first of a new round of Economic Summits, which have become a major feature of the international economic system.

At Ottawa, President Reagan re-established U.S. leadership in the economic sphere by a forceful presentation and defense of his economic program. Despite sharp differences over interest rates, East-West trade and North-South relations, the communique issued at Ottawa reflected all of the United States' major objectives -- an upbeat tone, no hint of protectionism, unified albeit ambiguous positions on North-South and East-West issues, an extraordinary degree of consensus on the nature of the Soviet threat and the Western response to it. Much of the "upbeat" tone can be attributed to the President's confidence that his economic program would lead to sharply lower inflation and sound, vigorous growth in the United States. While skeptical the other participants adopted a "wait-and-see" attitude about the U.S. program since it had not yet been fully implemented.

On balance, economic and political events since Ottawa have worsened certain alliance issues, particularly in monetary, trade and East-West relations. On the positive side, there is:

- -- sharp reduction in inflation in the U.S., more moderate slowdown in the UK, Germany and Japan;
- -- glut in the oil market, as a result of allowing market forces to spur conservation and non-OPEC production;
- -- downward revision in expected European gas needs affording time for exploration of alternatives to Soviet gas; and
- -- encouraging signs of life in key European economies, especially the UK and Germany.

But on the negative side, there is:

- -- recession in the U.S.;
- -- sharply rising unemployment, especially in Europe;
- -- persistently high U.S. interest rates;
- -- projections of large budget deficits in the U.S. and Europe, especially in France;
- -- exacerbation of major trade problems, such as in steel, agricultural products (European subsidies, corn gluten);
- -- heightened tensions within the EMS due to diverging economic policy among European countries; and
- -- imposition of martial law in Poland and tensions within the alliance over application of economic sanctions.

Given these events, the President's success at Ottawa will not be easy to duplicate. Even if economic activity is strengthening, unemployment in Europe will be at historic high levels, generating immense pressures for governments to "do" something. Meanwhile, many European leaders are engaging in a certain amount of "scape goatism" to transfer responsibility for their poor economic performance to the U.S., and U.S. interest rates in particular, rather than undertaking the necessary domestic policy actions to reduce inflation and revitalize growth in their economies. As importantly, unless the U.S. economy is performing better than now expected by late spring, the skeptics at home and abroad will be lobbying strongly for policy actions not consistent with the Administration's economic program.

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Events in Poland, and subsequent U.S. efforts to prompt an effective, united Western response, set the stage for a Summit discussion of East-West economic issues at Versailles. Economic difficulties in Europe will influence the European approach to this discussion. Nevertheless, the need for greater attention to credit flows to CMEA countries, in light of the vulnerability of the international financial system to seriatium defaults by those countries, is widely recognized. On another front, agreement at the high-level meeting of COCOM to strengthen controls on technology flowing to the East bodes well for more effective security trade controls assuming a continuing political commitment to that process.

Views of Other Participants and U.S. Strategy

The French and other European Summit partners are primarily concerned by short-term domestic economic issues -- unemployment, high interest rates, monetary policy - with particular focus on U.S. economic policy. The United States prefers to stress longer-term and more international issues such as trade and East-West relations, areas where progress has been made such as energy and North-South relations, and to point out the adverse consequences of certain domestic politics, such as subsidies, stop-go demand management, etc., on multilateral trading and financial relations and ultimately on prospects for domestic recovery and growth.

All other participants in the Summit will cite high U.S. interest rates as the factor now impeding recovery and destablizing exchange markets. For the French and perhaps the Italians, their preferred solution involves expansionary fiscal and monetary policy to attack unemployment directly. Most, however, support a firm anti-inflationary stance by the U.S. (and for themselves up to a point) but are critical of the projected U.S. budget deficits which they believe are holding U.S. interest rates far above justified levels. Some believe they are forced to match U.S. rates to avoid depreciation of their currencies. The Europeans, in particular, hold their position on all other issues, such as trade and investment issues and restraint on credits to the Soviet Union, hostage to U.S. action on deficits and interest rates.

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Japan will seek to avoid being isolated in the trade discussion, thus warding off direct criticism of its trade policies. In part, Japan will base its defense on the "undervalued" yen, caused by capital outflows attracted to the U.S. capital market by high interest rates.

On East-West issues most Summit participants will be more receptive to economic arguments for credit restraints and alternatives to Soviet energy than they will be to political arguments including direct linkage to the Polish crisis. In regard to the Siberian pipeline, they do not share U.S. assessments of the level of vulnerability associated with reliance on Soviet gas or the negative consequences of increased Soviet hard currency earnings generated by the pipeline. They are wary of the perceived U.S. objective to curtail East-West trade flows.

In this setting, the U.S. must take the offensive by emphasizing positive objectives rather than dwelling on the criticisms of U.S. domestic policy. To this end, we have concentrated on the following topics in the preparatory process:

-- greater international economic cooperation;

-- trade in the broadest sense as it relates to exchange of industrial goods, services, capital, and agriculture, to domestic adjustment policies, to technological innovation and to investment;

-- East-West economic relations, with particular emphasis on growing Western vulnerability to the debt build-up in the Soviet Union; and

-- energy security, as a unifying theme.

Improvement in the U.S. economy or altered expectations in the U.S. financial markets would significantly improve the climate at the Summit, and may make more achievable U.S. objectives in the international areas.

Versailles and NATO

The proximity of the Versailles Summit and the NATO Summit in Bonn makes particularly important a constructive meeting of the minds on the long-run economic prospects of the Western nations.

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On East-West issues the Summit Countries working within the NATO framework have responded to the Polish crisis by taking political and economic steps against the USSR and Polish governments. NATO can play a significant role in broadening a Versailles decision to restrict official credit flows to the USSR.

The two Summits could set in motion a process of shaping a reinvigorated world economic system for the 1982s beginning in the trade area with the GATT Ministerial scheduled for November 1982. Convergence of views on economic policy and on a stronger economic future will go far to insure a more positive attitude toward Western defense needs at Bonn. The Summits should reaffirm fundamental Western values of political freedom and economic opportunity in the face of political/military challenge and economic failure of Communist systems.

 4/28/82

OVERVIEW: MACROECONOMICS AND INTERNATIONAL MONETARY ISSUES

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objective

-- To obtain a commitment to a coordinated long-term policy approach, aimed at generating sustainable economic growth through price stability and the operation of market forces

Supplementary Objectives

-- To quiet the chorus of foreign complaints about U.S. policies

-- To express U.S. recognition of, and concern for, the economic problems faced by Summit partner countries, in place of foreign perceptions of U.S. indifference to their problems

II. BACKGROUND AND PRE-SUMMIT PREPARATION

(Updated paragraph to be supplied following OECD Ministerial and Interim Committee Meetings.)

III. OTHER COUNTRY OBJECTIVES AND STANCE ON U.S. OBJECTIVES

Again this year our Summit partners tend to blame their economic problems on U.S. policies. They continue to complain publicly -- largely for their own domestic audiences -- about the effect of large U.S. budget deficits and restrictive monetary policy on our interest rates. They argue that our high interest rates weaken their currencies and force them to follow excessively restrictive policies that postpone their recoveries. They appear to believe that the U.S. policy of non-intervention in foreign exchange markets (except in cases of severe disorder) has resulted in a higher dollar than would otherwise be the case, and in addition has contributed to increased exchange market instability. All of our Summit partners believe, at a minimum, that greater U.S. willingness to intervene, perhaps in concert with other major countries, would make exchange rates more stable. Mitterrand goes even further, calling for a return to fixed exchange rates.

The French are particularly outspoken on these points, perhaps because the markets have been especially harsh in judging French economic policies in contrast to ours. They also prefer to attack unemployment before inflation. The

Japanese maintain that high U.S. interest rates have produced a weak yen, creating additional trade irritations. Faced with a slow economy and a large budget deficit, they have attempted to stimulate domestic recovery by easing interest rates. The other countries are primarily interested in lower U.S. interest rates, believing that they could then allow their own rates to ease and speed up their recoveries.

Much -- but not all -- of this criticism is overdrawn, and reflects in part a strategy to deflect domestic complaints about economic conditions. Some European officials were embarrassed by the spectacle of Martens, whose own country has experienced years of undisciplined fiscal policy, being sent by the EC to lecture the United States on economic policy just prior to a devaluation of the Belgian franc made necessary by the exchange market consequences of domestic policy errors.

But these complaints also reflect genuine concerns. European unemployment rates have risen to the highest point since the end of postwar reconstruction -- over 9 percent of the labor force and over 15 million persons. Some feel that U.S. interest rates could be reduced by more rapid monetary growth, forgetting that a shift to higher monetary growth would signal lack of concern about inflation and increase the inflation premium in current (already high) nominal interest rate levels.

Others, such as Schmidt, are more concerned about federal budget deficits. They view the government's competition for a limited supply of savings as the major factor driving up interest rates. The remedy prescribed is lower defense spending and a rescinding of scheduled tax cuts.

IV. DISCUSSION OF OBJECTIVES

Coordinated Long-term Policy Approach

What all countries need is a common non-inflationary long-run approach to economic policy, predicated on monetary discipline, budget discipline, and non-interference with free markets. Trade frictions and exchange rate disturbances result mainly from differences in economic policies and performance -- particularly differences on inflation. The only long-run answer to these problems is uniformly sound economic policies. We would like to get a Summit commitment to long-term policy coordination, aimed at generating sustainable economic growth through price stability and reliance on market forces.

Talking Points

-- Answers to problems lie in our own hands. Difficulties the result of inflationary and undisciplined policies pursued in past, and government distortions of market mechanism. Undoing these not quick or easy, but possible.

-- Proper approach is sound non-inflationary policies -- monetary discipline, budget discipline, and non-interference with private markets. Must deal with underlying problems, not just hide symptoms.

-- We should agree to take actions to achieve coordinated long-term policy approach, based on price stability and market forces. This would lessen protectionist pressures, and put us on road to sustainable economic growth. Prior commitment to this would strengthen our ability to resist domestic pressures to abandon sound policies.

Respond to Foreign Complaints about U.S. Policies

Talking Points

-- We want to reduce our budget deficit and have been working with the Congress to achieve further expenditure reductions and revenue adjustments.

-- When budget deficits are examined on a comparable basis (the deficit of all levels of government -- federal, state and local -- as a percent of GNP), our deficits have been lower than those of most of our Summit partners. Even in the current year, when our deficit ratio is exaggerated by our recession, we will be below all the others except Japan.

-- There is no simple relation between budget deficits and interest rates. Our deficits are low in relation to the total private saving from which the financing of deficits comes. In 1981, for example, the federal deficit was only 13 percent of private saving. Probably the largest impact stems from the uncertainties surrounding our projected deficit and the resulting adverse effects on market psychology. This is causing a "risk premium" to be reflected in current interest rate levels.

-- Our responsibilities as the free world's leader require that we strengthen our defense capabilities.

-- In the past our friends have told us that we needed to make strong efforts to put our house in order -- to reduce inflation and to strengthen the dollar as the main internationally held currency. Now we are doing it. Markets have contrasted our achievements with weaker performance abroad. Both the judgment of relative economic performance and international political developments like the Polish situation have led to a stronger dollar.

-- We <u>are</u> prepared to intervene, if necessary, to counter market disorder.

-- We do not believe it is possible for any government, or a group of governments, to get together to set exchange rates at levels different from those established by market forces -- the markets are just too big for that.

U.S. Recognition of Economic Problems Faced by Summit Partners Countries

Our Summit partners sometimes appear to believe that we are unconcerned about their economic problems. They do not understand that, when we reject such proposals as those for coordinated foreign exchange market intervention or expansionary monetary policies, it is not because of indifference to their concerns but rather because such policies would not be successful. That is why we believe that each country is best served by domestic policies that will combat inflation and renew long-run, sustainable, noninflationary growth.

Talking Points

-- We are interested in our Summit partners' economic concerns and are ready to listen to their views.

-- The greatest contribution we in the United States can make is to get our own house in order and thereby restore non-inflationary growth.

INTEREST RATES/BUDGET DEFICITS

I. ISSUE

Europeans complain that excessively tight money and large budget deficits have driven U.S. interest rates unnecessarily high, requiring Summit partner countries to keep their interest rates up too in order to avoid a fall in their exchange rates. They claim that these "artificially" high interest rates in their own economies discourage investment and create slow GNP growth and rising unemployment. Some foreign critics want the Administration to pressure the Fed to expand the money supply more rapidly. There is a more widespread belief we should reduce our budget deficit quickly, perhaps by defense cuts and/or postponement of the July tax cut.

II. ESSENTIAL FACTS

The U.S. view is that we too want to get interest rates and budget deficits down. The only way to get interest rates down is to get inflation rates down. We are working with the Congress to get the budget deficit down by further expenditure cuts and revenue adjustments.

III. TALKING POINTS

Criticism: U.S. should ease too tight monetary policy, thereby allowing interest rates to fall.

Response:

-- Restrictive monetary policy is winning the battle against inflation. But the market has not yet fully appreciated the magnitude and permanence of this reduction in inflation. As a result, the big decline in interest rates is still to come.

Criticism: United States should reduce its budget deficit quickly, because the high level of government borrowing is keeping interest rates high.

Response:

-- We want to reduce our budget deficits and are working with Congressional leaders to achieve further expenditure cuts and revenue adjustments.

-- Our deficits on a comparable basis (total government sector deficit as a percent of GNP) have been lower than most of our Summit partners. Even in 1982, when the ratio is exaggerated by our recession, we are below all the others except Japan.

-- There is no simple relation between budget deficits and interest rates.

EXCHANGE RATE POLICY

I. ISSUE

Other Summit country leaders want us to undertake a more active foreign exchange market intervention policy.

II. ESSENTIAL FACTS

Most of the other Summit country leaders are unhappy about high dollar exchange rates and U.S. unwillingness to intervene in foreign exchange markets. They are less willing than we to accept market verdicts about exchange rates, and think that market instability is increased by the market's knowledge that we will not intervene except in the most unusual circumstances. The Japanese may go so far as to call for U.S. intervention to push the dollar down, reflecting their concern about the 9 percent rise in the dollar's value relative to the yen so far in 1982. The dollar rose almost 11 percent against foreign industrial country currencies in 1981 on a trade-weighted average basis, and has risen another 7 percent so far this year. Mitterrand has begun talking about a return to fixed exchange rates and may suggest it in Summit discussions.

III. TALKING POINTS

Criticism: The U.S. non-intervention policy increases market instability.

Response:

-- We are prepared to intervene, if necessary, to counter market disorder, and have in fact been prepared to go into the market on a couple of specific occasions. In each instance, however, the markets settled themselves so quickly during our trading day that no actual U.S. intervention seemed appropriate.

-- The focus of attention in all countries, including the United States, must be on the fundamental economic policies that will combat inflation and renew growth. This is what provides the underlying basis for exchange market stability.

Criticism: (French and Japanese) The dollar is too high and joint intervention to encourage a lower rate should be undertaken.

Response:

-- We do not believe it is possible for any government, or a group of governments, to get together to set exchange rates at levels different from those established by market forces -- the markets are just too big for that.

4/29/82

ECONOMIC POLICY COORDINATION

I. ISSUE

We would like to convince our Summit partners that a coordinated long-term approach to economic policy, focusing on price stability and private market activity, would make a major contribution to solving international economic problems.

II. ESSENTIAL FACTS

Our Summit partners at times seem overwhelmed by their present economic difficulties. Many governments (particularly in Europe) face political pressures to find a quick solution for their problems. Since no such solutions are available, they have turned outward -- blaming their difficulties on the United States and Japan.

We would argue that there is no quick fix -- that what all countries need is a common non-inflationary long-run approach to economic policy, predicated on monetary discipline, budget discipline, and non-interference with free markets. Trade frictions and exchange rate disturbances result mainly from differences in economic policies and performance -- particularly differences on inflation. The only long-run answer to these problems is uniformly sound economic policies, not exchange market intervention or protectionism. We would like to get a Summit commitment to long-term policy coordination, aimed at generating stable economic growth through price stability and reliance on market forces.

III. TALKING POINTS

U.S. Points:

-- Proper approach is sound non-inflationary policies -- monetary discipline, budget discipline, and non-interference with private markets. Must deal with underlying problems, not just hide symptoms. Thus, answer to trade problems is adjustment, not protectionism. Answer to exchange market turbulence is greater similarity of economic policies and performance, not intervention.

-- We should agree to take actions to achieve coordinated long-term policy approach, based on price stability and market forces. This would lessen protectionist pressures, and put us on road to sustainable economic growth. Prior commitment to this would strengthen our ability to resist domestic pressures to abandon sound policies.

Economic Impact of the Oil Price Decline

I. ISSUE

Lower oil prices will have a positive effect on economic performance in the major industrial countries. Estimates of the size of this effect depend crucially on whether the recent decline will continue in the future or be reversed. In addition, since oil prices are quoted in dollars, exchange rate movements will affect the magnitude of a given decline in price for countries other than the United States.

II. ESSENTIAL FACTS

Average official sales prices in international trade have declined by approximately one dollar per barrel over the past six months. Official sales prices do not, however, take into account special deals, credit arrangements, blending, etc., so that they probably understate the decline.

Spot market prices declined throughout 1981 and early 1982, but have firmed somewhat over the last few weeks. Over the past 6 months, Arabian light crude has gone from about $35 a barrel to $28 and back up to $30.

A sustained 10 percent cut in oil prices would be expected to raise output in the OECD countries by half a percentage point, reduce the inflation rate in the near term by between one-half and one percentage point, and raise the current account surplus by $10 billion. Because oil prices are quoted in dollars, the distribution of these benefits among OECD countries will depend on changes in the dollar exchange rates of these countries.

Several governments (Canada, France, Italy, and Japan) may try to prevent oil prices from falling because of an overriding desire to maintain pressure for conservation.

III. TALKING POINTS

Criticism: Falling oil prices will represent a set back for efforts in OECD countries to conserve energy and substitute other forms of energy for oil, unless taxes on oil products are adopted.

Response: Attempts to raise artificially the price of oil products through an energy tax will needlessly impose an obstacle to economic recovery. At present there is little reason to expect firms that have invested heavily in conservation measures to react to falling oil prices by shifting back to more oil intensive processes.

Criticism: As oil prices decline, OPEC surpluses will dwindle thereby reducing world saving and putting upward pressure on interest rates.

Response: Economic policies designed to reduce budget deficits, stimulate private saving, and spur productive investment can reduce the possibility that shrinking OPEC surpluses will actually reduce world saving. On the contrary, proper policies can help sustain a strong economic recovery without raising interest rates.

Versailles Summit
Trade Overview Paper

I. U.S. Objectives and Initiatives

A. Principal U.S. Objective: Obtain support for a productive GATT Ministerial as a key element of a political commitment by governments to preserve the open trading system and to provide the basis for strengthening the system through future negotiations.

Economic stagnation is fueling growing protectionist pressures, and many no longer believe that further gains from trade are possible. In addition, the emergence of trade problems which are inadequately covered by the existing rules are diminishing the effectiveness of the trading system.

The Summit group must demonstrate leadership by re-establishing the notion that there are economic opportunities and mutual gains from trade and by setting directions for further efforts to strengthen the trading system in the 1980s. The nature of the current threat to the system is such that, in the absence of concrete efforts to continue liberalization, retrogression is almost inevitable. A strong political statement by the Summit countries would be a signal to the world that they are optimistic about the prospects for maintaining and strengthening the open trading system.

B. Supplementary Objectives:

1) Obtain a political statement of the Summit countries to resist short-run protectionist measures and to resolve current issues in accordance with the spirit and letter of GATT rules.

2) Deflect European criticism of U.S. remedial trade measures in steel and agriculture by shifting the focus to a discussion of long-term adjustment problems.

3) Encourage Japan to take additional steps to open up its market.

C. Initiatives

1) Obtain a political statement which commits the Summit countries to pursue an active work program dealing with the key trade issues of the 1980s with the objective of maintaining the open trading system and amplifying the GATT. Summit leaders would endorse the OECD work program adopted by ministers in May and would urge the world's trade ministers to establish the direction for the GATT in the 1980s at their meeting in November.

2) Commit Summit countries to facilitate the adjustment of their economies to the new technologies and increased competition from the developing countries in manufactures and to strengthen political cooperation by their trade ministers to assure expansion of trade opportunities for the sectors where we have the greatest stake.

3) Endorse the U.S. proposal for new negotiations between the more advanced developing countries and developed countries, leading to graduation commitments by developing countries and to commitments of more assured market access by developed countries.

II. Background and Pre-Summit Preparation

A preparatory committee has been meeting in Geneva and has been laying the groundwork for the upcoming GATT Ministerial in November. The consensus-making process is moving forward.

The substantive trade issues will have been discussed at the OECD Ministerial May 10-11. Secretary General Van Lennep's action proposals on trade issues of the 1980s will be the focus of that discussion.

Ambassador Brock also will have met May 12-13 with his counterparts from the European Community, Canada and Japan in the second quadrilateral meeting. The first was held in January in Florida.

In all of these fora our position has been to push for the development of a work program in the GATT to:

1) Speed-up implementation and enforcement of the MTN codes.

2) Improve and extend existing rules (e.g., safeguards, agricultural subsidies).

3) Lay the analytic groundwork for new multilateral negotiations covering barriers to trade in services. trade-distorting investment practices, trade in high-technology products, and adherence of the LDCs to the spirit and letter of GATT.

III. Other Country's Objectives and Stance on U.S. Objectives

European attitudes are heavily influenced by their growing unemployment problems. Those problems are not just cyclical because overall European employment has not increased in the past seven years. At the same time, there is growing pressure in Europe to adjust to increasing international competition and technological change. Many Europeans lack faith in the future and, in some quarters, government interventions are being advocated as the way to reduce their economic hardship.

While the Europeans have grudgingly agreed to discuss new or unresolved trade issues at the GATT Ministerial, they will be reluctant to go far in terms of giving a strong political endorsement to an active work program in the GATT. They feel the current climate is not right for further efforts to strengthen the trading system and would prefer instead to merely renew the commitment to the existing system. At GATT, they will probably only support continued studies and fact-finding. Our view is that the credibility of the trading system is undermined if we do not go beyond the existing arrangements to establish rules to deal with new trade issues or those not adequately covered by the existing arrangements.

On our other initiatives on cooperation on adjustment issues and establishing a dialogue with the advanced developing countries, the Europeans are under considerable political pressure to intervene in response to the unemployment and adjustment problems they face. There is support for engaging in a dialogue with the developing countries, but some countries (e.g., France) will probably urge global negotiations as the best approach. We welcome a dialogue with the developing countries, but one that is structured so that the role of the specialized agencies is preserved.

The Europeans are concerned about the possibility that the United States may take remedial measures against their subsidies and discriminatory practices in steel and agriculture.

Europe is also very concerned, as is the United States, over the size of the trade deficit with Japan even though Europe has a larger bilateral deficit with the United States. The Europeans feel that the Japanese market is closed, and they have applying considerable pressure on the Japanese to take additional steps to open their market.

Japan will be more supportive of an action agenda on long-term issues but may have to spend much of the time defending itself unless they announce substantial new trade liberalization measures prior to the Summit.

Canada will also be more supportive of an action agenda on long-term issues. One exception is our effort to increase international discipline on trade-distorting investment practices because Canadian policies have been a major impetus behind our efforts.

IV. Discussion of Objectives

Our primary objective is to maintain and expand the open trading system. 1982 may prove to be a watershed for the system. Protectionist pressures emanating from the current recession, long-term economic adjustment problems, grievances over the lack of access to some markets, and the emergence of many new trade issues not covered by existing rules pose a major challenge to the credibility and viability of the open trading system.

Most of these problems reflect an underlying and long-term structural problem. At a time when the pace of economic change is accelerating and international economic interdependence is growing, many domestic economies and the international system as a whole are increasingly unable to adjust to worldwide economic change.

The conflict between the need to adjust and growing inflexibility and rigidity spills over into political pressure to protect and insulate domestic groups from market forces. For many governments the politically expedient course is to shift the blame for (largely domestic) economic problems to foreigners and to erect a variety of direct and indirect trade barriers. The GATT's success in lowering tariffs has shifted the focus of protectionism to more subtle non-tariff barriers and trade-distorting practices.

We need to reestablish that there are economic opportunities and mutual gains from trade and to highlight the important role that trade liberalization has had and can have accelerating the growth of the world economy.

Our short-term objective is to discourage the proliferation of new protectionist measures as a quick-fix for structural economic problems. The summit group must make a commitment to support and strengthen the international trading system. As part of this commitment they should resolve to deal with current trade problems by seeking solutions that are consistent with the spirit and the letter of the GATT, rather than resort to protectionist actions.

Our longer-term objective is to give new impetus to trade liberalization. We need to establish a GATT work program which addresses the new trade issues and lays the groundwork for future negotiations.

Progress has been slow in implementing and enforcing the MTN nontariff barriers codes. New trade barriers and distortions not covered by GATT rules are constantly emerging. To give new impetus to further liberalization, our reinforcing objectives are to (a) press for faster implementation of the MTN codes, and (b) to commit ourselves to expand GATT authority over trade in services, agriculture, and high technology products and to strengthen international discipline over trade-distorting investment practices.

We should also propose establishment of a political dialogue between the more advanced developing countries and the OECD countries concerning mutual interests in the trade area. This could involve an exploration of steps each side could take to achieve a more equal partnership, taking account of the interest of developed countries in assuring that developing countries more fully assume GATT obligations, and taking account of the interest of developing countries in access to developed country markets.

Improvement in the international rules governing trade barriers and distortions must be reinforced and accompanied by a commitment to long-term structural adjustment. This will require governments to recognize that to achieve long-run non-inflationary growth and to reap the benefits of trade, painful adjustments may be necessary.

In the last twenty years governments have instituted a variety of economic and social programs which, while deeply rooted in desires for social justice, have inhibited mobility and wage and price flexibility. If we are to avoid new forms of protectionism and make progress in eliminating existing distortions, policy must focus on enhancing rather than reducing economic flexibility and adaptability. The OECD positive adjustment exercise began to analyze the sources of impediments to adjustment and their implications for trade and long-run growth. We should support continued efforts at identifying impediments to adjustment.

I. Descriptive statement of the issue.

The trade ministers of the member countries of the General Agreement on Tariffs and Trade (GATT) will meet November 23-26 in Geneva. The meeting marks the first time since 1973 that the member countries have met at the ministerial level. This session will be held during a period of strong protectionist pressures resulting in large part from the prolonged recession that has gripped key member countries. Decisions taken at the Ministerial will set the course of GATT activity during the 1980's, and can determine whether or not the organization will continue to be a major force for trade liberalization.

II. Essential factors.

The United States objectives for the GATT Ministerial are to strengthen the GATT, resist protectionism, provide a forum for discussion of developing country trade issues, and launch a program for trade liberalization in the 1980's. Our major trading partners share these objectives, but negotiations on the final agenda for the meeting are continuing. It is not expected that the agenda will be finalized until mid-June.

The United States supports a three-part agenda: a) a positive political commitment to expand trade and resist protectionism; b) ministerial decisions on issues which could be resolved in the near-term and which would strengthen or reaffirm GATT principles, including a review of the Tokyo Round agreements and the on-going activities of the GATT, and completion of negotiations on the safeguards and counterfeit codes; and c) adoption of work programs on the emerging issues of trade in services, trade-related investment practices, and trade in high technology goods, as well as problems of agricultural trade and the trade issues confronting developing countries.

III. Key points to make.

-- We strongly support the GATT Ministerial. Given the difficult global economic situation and the increasing pressures for protectionism, we have an important stake in seeing that there is agreement on how to strengthen the system.

-- We anticipate that there will be a common assessment of the current economic situation and a positive political commitment to strengthen the GATT and resist protectionism. The tone of this statement will shape the work of the GATT over the next decade.

-- We support an agenda that distinguishes those issues which could be resolved in the near-term from those which require longer-term work programs. With regard to the latter, we believe that the GATT cannot ignore the emerging issues of trade in services, trade-related investment practices and trade in high technology goods. Likewise, we believe that the trade ministers must address agricultural trade issues and the trade problems of developing countries.

Final
4-26-82

USG INVESTMENT INITIATIVE

I. ISSUE

The United States wants to begin to develop multilateral rules for investment. As a first step, we want Summit countries to agree to examine investment issues in multilateral fora such as the GATT and the OECD.

II. ESSENTIAL FACTS

Many governments restrict investment or impose measures aimed at skewing the benefits of foreign investment in their favor at the expense of distorting international flows of investment and trade. These measures include barriers to investment, conditions relating to ownership and technology transfer, requirements to source purchases locally or export a minimum volume or percentage of output ("performance requirements") and fiscal or other incentives which are tied to certain restrictive investment conditions.

These measures discriminate against foreign investment; they result in an inefficient allocation of resources; they fuel protectionist pressures; and they jeopardize the international economic system. Restrictive investment policies are followed by developed countries such as Canada and France and by advanced developing countries such as Brazil, India, and Mexico. Most countries resist international scrutiny of investment policies; however, West Germany, Switzerland, Japan and perhaps the United Kingdom hopefully will support a limited U.S. initiative in the GATT and the OECD.

III. TALKING POINTS

Criticism: There is no need for a new initiative. Other institutions are analyzing these issues.

Response: We are pleased with the work of the OECD and others. This work falls short, however, because it doesn't include the developing countries, is not binding on all countries, and doesn't represent an effective framework for dealing with most investment problems. Also, the trade-distorting aspects of the problems need to be addressed by the GATT.

Criticism: This is mainly an American problem.

Response: Investment is not just an American issue. Globally, direct investment is increasing and restrictive practices are proliferating. Other countries, particularly those with open economies, are being hurt.

Criticism: Many developing countries use performance requirements for legitimate economic development purposes.

Response: While developing countries may sometimes use investment policy as a development tool, certain of these practices distort trade and investment flows, and there is a need for discipline.

Nontariff Barriers

I. Descriptive statement of the issue.

Despite the progress in international trade liberalization which has occurred over the last thirty-five years, we recognize that the U.S. today faces an increasing number of nontariff barriers which restrict our ability to trade with and invest in other countries. Further work in the OECD and the GATT is needed to address these barriers and enhance trade liberalization.

II. Essential factors.

The U.S. attaches a great deal of importance to the nontariff barrier codes negotiated during the Tokyo Round including those on customs valuation methods, import licensing practices, antidumping procedures, technical barriers to trade (i.e., product standards), government procurement procedures, trade in civil aircraft and the use of subsidies and countervailing duties. The U.S. is committed to the vigorous enforcement of those agreements, is actively involved in the Geneva code committees which oversee each of the codes, and have made it clear that we expect signatories to fully comply with the codes. We are also seeking to broaden the relevance of the codes by encouraging more of the developing countries to sign them.

In addition to insisting on full implementation of the Tokyo Round, we also need a revitalized trading system designed to deal with new barriers as they arise and with barriers not covered by existing international rules. Hence, our objectives for the November 1982 GATT Ministerial are, among others, to deal with nontariff barriers in the services and investment areas, as well as those related to agricultural trade and high-technology goods.

III. Key points to make.

-- The U.S. strongly believes that, despite the present international economic conditions, there must be a strong commitment by the U.S. and its trading partners to continued liberalization of nontariff barriers in international trade and investment.

-- We believe that the Tokyo Round nontariff barrier codes must be vigorously enforced and fully complied with. Moreover, the U.S. encourages the active participation of the developing countries in the new GATT codes, and supports the exploration of new areas to which individual codes might be extended.

-- We feel that the November 1982 GATT Ministerial provides an excellent opportunity to address remaining nontariff barrier issues (such as trade in counterfeit goods, safeguards measures, trade in services, investment-related barriers) and that the Ministerial should not only review the operation and implementation of the MTN agreements, but should also chart a course for international trade activities for the 1980s.

STEEL TRADE

I. ISSUE

On June 10, the U.S. Department of Commerce will announce, pursuant to statutory deadlines, preliminary decisions in 36 steel countervailing duty investigations, 19 of which involve EC producers.

II. ESSENTIAL FACTS

These investigations, were begun in response to petitions filed by seven U.S. steelmakers in January. DOC has issued questionnaires to foreign steelmakers and governments from which it will calculate the amount of any net subsidies affecting the imported merchandise. Import duties equal to the net subsidy become payable at the time of the June 10 determination, contingent on final subsidy and material injury determinations (due August 14 and October 8 respectively). Preliminary decisions in the 17 EC antidumping investigations filed concurrently with the subsidy complaints are required by August 9.

The EC is concerned that exports of affected steel products ($1.2 billion in 1981, 3 percent of all U.S. imports from the EC) will be excluded from the U.S. market. While these exports accounted for only 3 percent of total EC steel production in 1980, the loss or redirection to the EC market of this production could endanger restructuring efforts and exacerbate steel-related domestic economic and political difficulties, most notably in Belgium. Japan is satisfied with its steel export markets and seeks stability in world steel trade. It fears the disruption of world steel trade that might follow imposition of countervailing duties by the U.S.

We see EC subsidies, which maintain excess and inefficient capacity, at the heart of current world steel trade frictions. Twice before, in 1977 and 1980, the USG has worked out compromises that avoided the strict application of US trade laws to EC steel imports; both times the compromise failed, most recently because of massive increases in EC steel imports. We now intend to complete the subsidy and antidumping investigations and, if warranted, impose duties to offset unfair trade.

III. TALKING POINTS

Criticism: European steel exports to the United States have not exceeded traditional levels and are not injurying the U.S. steel producers. The USG should dismiss the cases.

Response:

-- The Department of Commerce is handling the steel cases fairly, objectively, and in full accordance with our international obligations under the General Agreement on Tariffs and Trade (GATT).

-- Commerce's intention is to complete the investigations, identify which steel is being fairly traded and which is not, and impose duties to offset any injurious unfair dumping or subsidization. We are willing to listen to suggestions for settlement, but any settlement must be consistent with U.S. laws and the free and fair trade policies of the United States and the GATT.

SECTORAL ISSUES -- AGRICULTURE

I. ISSUE

The President should raise the importance to the United States of fair international trade in agriculture and of the adverse consequences caused by export subsidies. He should seek a commitment that the GATT Ministerial address agricultural trade problems directly, not relegate them to a separate agricultural committee.

II. ESSENTIAL FACTS

U.S. farm income is at its lowest point since the Depression. Up to 40% of U.S. crop production depends on export earnings.

The European Community (EC) took $9 billion--21%--of our agricultural exports last year, but it is considering to limit purchases of a major export, corn gluten feed, despite duty free commitments negotiated internationally. The EC provides unlimited subsidies to production and exports, creating unfair competition in third country markets for important U.S. exports such as wheat and poultry, and weakening world market prices that force the U.S. to stiffen support at home for products like sugar and cheese. The United States has filed several formal complaints against the EC's use of subsidies to finance agricultural products in these third country markets.

Japan, a $6.6 billion customer of U.S. agricultural products, continues to maintain illegal import quotas on U.S. farm products.

III. TALKING POINTS

Criticism: The European Community says that its domestic farm programs are based on socio-political considerations, that international agricultural trade problems should be managed (i.e., subject to international commodity agreements), and that the U.S. concurred in the EC export subsidy policy at the last trade negotiating round. Japan opposes reducing its import controls on agricultural products for domestic political reasons.

Response:

-- EC agricultural policy resolves domestic problems by transferring them to the international markets, adversely affecting U.S. farmers. U.S. believes there should be more international discipline on subsidies. There was no concurrence in the EC export subsidy policy.

-- GATT Ministerial provides an opportunity to deal with these problems, though an agricultural committee should be avoided.

-- The situation with Japan calls for immediate action.

RECIPROCITY

I. ISSUE

There is a growing concern in the U.S., fed by frustration with our inability to gain satisfactory access to Japan's market, that competitive U.S. firms do not have the same quality of market access abroad as do foreign firms exporting to the U.S. The Congressional response to this has been the widespread introduction of "reciprocity" bills.

Those bills have raised fears both at home and abroad that reciprocity legislation will move us toward protectionism.

II. ESSENTIAL FACTORS

The Administration may be able to keep reciprocity legislation from forcing protectionist actions, but we will be given a mandate to get results in trade talks on services, investment, and high technology. In addition we will reaffirm our commitment to vigorously enforce U.S. rights under trade agreements. Accomplishing these two objectives, and increasing market access, should enable us successfully to contain protectionist pressures.

However, reciprocity legislation could become protectionist if we cannot improve market access abroad, in part through meaningful commitments from our trading partners to practice fair and open trade. Japan is, as it should be, particularly concerned, but foreign barriers to market access are widespread.

III. KEY POINTS

- Reciprocity legislation reflects a strongly held view that market access abroad must be improved.
- We must make progress to improve the openness of the trading system or we will not be successful in controlling reciprocity legislation.
- The Administration will not accept any legislation that is not fully consistent with our international obligations.

(Briefing Paper for Summit
M. HATHAWAY, USTR, 395-3432)

U.S./JAPAN

Issue

Japan must accept greater responsibility for and exercise increased leadership in the world trading system. The most critical part of this responsibility is to fully open its economy and ensure greater access for U.S. exports.

Essential Factors

The U.S. trade deficit with Japan is expected to swell from $16 billion in 1981 to $20 billion in 1982. This has generated a rising level of frustration and anger in the U.S. farm, labor, and business communities which is reflected in growing Congressional activity to legislate a more reciprocal trade relationship. The Administration is embarked on an intense and sustained effort to achieve substantially greater access to the Japanese market in sectors where we are competitive. Japan's other trading partners face a similar situation: in April the EC filed a formal GATT complaint against Japan. Now that Japan is the second largest economy, it must begin to exercise greater leadership and take responsibility for strengthening the international trading system. Japan's failure to provide access to its economy threatens the world trading system and may lead to U.S. action which would severely damage our bilateral relationship.

Key Points to Make

We expect a package of initiatives from the Japanese Government about mid-May. Appropriate key points will be supplied at that time.

TRADE IN HIGH TECHNOLOGY

I. ISSUE

The United States is concerned by foreign government practices that protect their high-technology firms and adversely affect the competitive position of U.S. firms in U.S. and foreign markets. The United States has asked that this issue be placed on the agenda for the GATT Ministerial in November and that OECD work on high-technology trade and investment issues be expanded.

II. ESSENTIAL FACTS

Advanced technology spans a wide range of industries having in common "knowledge-intensive" bases derived from continued investment in research and development, and the aggressive application by these industries of innovations concerning new products and processes. In some countries, there are formal, coordinated government efforts employing a broad range of policy instruments which are designed to promote these industries in ways that could injure the foundation of the international trading system. U.S. companies operate without such goverment programs or protection from competition in the U.S. market.

III. TALKING POINTS

-- Advanced technology will be a significant source of economic growth and productivity for all our economies in the 1980's if we work together to ensure that our governments adopt policies to promote vitality and competition, and resist protectionism and other trade-distorting measures.

Criticism:

-- The United States is the leading exporter of high-technology. Other countries perceive the need to involve their governments in support of their private sectors to catch-up. High-technology trade problems are already addressed in the GATT. It is not entirely clear that problems affecting high-tech trade are serious enough to warrant a major allocation of resources for work programs in the GATT & the OECD. We may want to go slow.

Response:

-- Pressure is already very strong in the United States to react against foreign trade barriers to U.S. exports that are perceived as unfair and inequitable. Legislation is being seriously debated requiring reciprocity in U.S. trade relationships. We must demonstrate that the international trading system can respond to the changing nature of international trade.

EAST/WEST ECONOMIC ISSUES

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objective

1. Obtain Allied government cooperation in limiting the volume and raising the cost of official credit flows to the Soviet Union and monitoring Eastern European debt service problems.

Supplementary Objectives

2. Endorse results of January COCOM HLM and agree that continued high-level attention needs to be devoted to strengthening the COCOM control system, national enforcement and COCOM's organizational structure.

3. Seek allied agreement to work with us to limit dependence on Soviet energy and consider energy alternatives.

Initiatives

1. Secure Summit blessing of an arrangement in principle to monitor and restrain Western government-backed lending to the USSR and to raise the costs of such lending to market rates, provided negotiations are sufficiently advanced.

2. Recommend another High-Level COCOM meeting in late 1982 or early 1983 to review the progress made during the list review and provide additional political guidance for strengthening COCOM; make available funds to strengthen COCOM institutionally; and agree to tighten enforcement of national exports control laws and regulations.

3. Call for European commitments to: (a) foreswear new gas supply contracts with the Soviet Union; (b) establish a "gas safety net" to mitigate the effects of supply interruptions; and (c) work with other Summit nations to develop energy alternatives, particularly accelerated North Sea gas and U.S. coal.

II. BACKGROUND

East-West economic relations were discussed at the Ottawa Summit last year. As a result of Allied agreement at Ottawa, a high-level COCOM meeting was held in Paris on January 19-20, 1982, to strengthen export controls on sensitive technology to the Soviet Union and Warsaw Pact. Since Ottawa, two further developments have required Allied action--the serious deterioration in the economic and financial situations of a number of Warsaw Pact countries, most notably Poland, and the declaration of martial law in Poland. In addition to Allied political and economic sanctions directed at Poland and the USSR, the U.S. (Buckley High-Level Mission) has proposed that the Allies develop a cooperative framework to restrict significantly the flow of government-backed credit and credit guarantees to the Soviet Union. The objective is two-fold: to prevent the Soviets from accumulating enough debt to obtain leverage over the West and make Soviet decisions to increase defense spending more difficult at the margin. Bilateral and multilateral meetings with key allies are parallelling Summit preparations and are striving for a credit control agreement that can be endorsed by Summit Seven leaders. Complementary work on export credits is also continuing within the OECD Credit Arrangement which will result in reclassifying countries, including the USSR, based on increased wealth. Our objective is to raise interest rates and thereby reduce substantially the subsidy element in Western official lending to the Soviet Union.

A subordinate objective of the Buckley mission is to get agreement to limit European dependence on Soviet energy. France and Germany were not overly receptive to the energy security objectives of the Mission, although they were willing to continue to work with us on safety net planning. The Italians, while expressing considerable interest in a variety of non-Soviet energy alternatives, made it clear that they ultimately intend to take Soviet gas from the pipeline now under construction. However, since the Buckley Mission, a continuing softening of prospective European gas demand and quiet re-evaluation of import needs may have created an environment in which Europeans are more receptive to the concept of a limit on import dependence based on foreign policy considerations.

Thus, the prospects that we might obtain European commitments to avoid a "second strand" of the Yamal Pipeline and reduce offtake from the planned pipeline are more promising. Any European pledge should include commitments not to undertake credits and equipment sales for a second pipeline. However, with soft demand, obtaining governmental commitments becomes more important in order to stimulate development of large scale and possibly higher cost energy alternatives, such as North Sea gas.

III. OTHER COUNTRY OBJECTIVES AND STANCE ON U.S. OBJECTIVES

The West European Summit participants will be engaged in a damage limitation exercise, seeking to: 1) insulate their East-West political, economic and cultural ties from renewed U.S.-Soviet cold war tensions as a result of events in Afghanistan and Poland, 2) minimize the scope of U.S. economic sanctions and export controls on Poland and the USSR; and 3) enlist U.S. cooperation in resolving the financial crisis in Eastern Europe (Poland and Romania) that threatens West European commercial and financial interests in particular. The West Germans, who believe they derive substantial political and social benefits from their trade links with Eastern Europe and the Soviet Union, and will resist what they view as U.S. efforts to "punish" the Soviets. They will remain highly skeptical of U.S. arguments that "business as usual" with the East and the Soviet Union, in particular, damages Western security. The U.K., and especially the French, while more understanding of U.S. strategic concerns, will seek to protect commercial/economic interests in light of rising domestic unemployment and balance-of-payments concerns. In light of the discussions thus far, however, we think that we have a reasonable chance of getting an agreement on credit restraints by the time of the Versailles meeting that can be endorsed by the Summit participants.

We can expect no retreat by the Europeans from commitments already made with respect to Soviet oil and gas development. Indeed, there may be considerable pressure from the British, Italians, French and Japanese for an easing of U.S. sanctions policy to permit the sale of oil and gas equipment their firms have already contracted to deliver to the Soviets. Prime Minister Thatcher has suggested we consider such an easing, which in the British case would allow the export of U.S. GE rotors to financially pressed John Brown Engineering, in return for unspecified European "comparable measures".

IV. DISCUSSION OF OBJECTIVES

1. Credit Controls. The Polish financial crisis has underscored another source of Western vulnerability and potential Soviet leverage: the existing large stock of Soviet and Eastern European debt owed to the West. The West must deal with the problems arising from Eastern Europe's existing debt and growing Soviet indebtedness, which could eventually undermine Soviet creditworthiness as well.

   - Allied cooperation on Polish debt management and monitoring other Eastern European financial problems and credit flows is essential to advance our political interests and to safeguard Western financial interests and the international monetary system.

- Similarly, Western economic and strategic interests must be protected by an agreement to restrict the flow of officially-supported credit to the Soviet Union.

2. COCOM. The COCOM high level meeting agreed to at last year's summit was an important first step towards increasing the effectiveness of our multilateral export controls. Continued high level backing will be needed if our efforts to avoid contributing to Soviet military capabilities through our exports of sophisticated equipment and technology are to be successful.

   - Another high level meeting should be held in late 1982 or early 1983 to review progress made during the list review, give additional political guidance for strengthening COCOM institutionally, and encourage work to strengthen embargo enforcement at both the COCOM and national levels.

3. Energy Dependence. Despite differing views about what might constitute vulnerability, all Summit countries wish to avoid a situation in which excessive dependence on Soviet energy and/or other raw materials could inhibit Western foreign policy freedom.

   - There is a clear need for the Europeans to limit their dependence and vulnerability to Soviet leverage and assure that development of alternative supplies (e.g., Norwegian gas) is not impeded.

   - The U.S. is prepared to work together with other governments on measures which would enhance Western energy security.

COCOM/STRATEGIC TRADE

I. ISSUE

Endorsement of the results of the January COCOM High Level Meeting (HLM) by the Versailles Summit could help to maintain the momentum of Allied efforts to improve multilateral embargo on exports of strategic items to the Warsaw Pact countries.

II. BACKGROUND

The agreement at the Ottawa Summit to "consult to improve the present system of controls on trade in strategic goods and related technology with the USSR" resulted in the January COCOM High Level Meeting, the first such meeting in over two decades. A consensus was reached on the need to: (1) ensure embargo coverage of critical equipment and technology by giving priority attention to certain specified strategic areas while deleting noncritical items; (2) strengthen embargo enforcement activities at the COCOM and national levels; and (3) harmonize national licensing practices and procedures.

The United States and other COCOM members have put forward several proposals to strengthen embargo coverage, improve enforcement, and harmonize licensing practices. More such proposals will soon be submitted to COCOM.

III. TALKING POINTS

US Statement: The COCOM High Level Meeting in January underscored the importance the members attach to the multilateral export control system. We agreed at that meeting to explore means of improving COCOM embargo coverage, administration, and enforcement. The momentum stimulated by this meeting should be maintained by prompt and constructive action in the regular COCOM Committee and within national governments to put into effect specific improvements.

-- Specifically, we should:

(a) Continue to devote high-level attention to COCOM efforts to strengthen embargo coverage;

(b) Develop means to reduce diversion through non-COCOM countries;

(c) Exchange more intelligence and other information concerning diversions;

(d) Work towards an effective harmonization of national export control procedures;

(e) Modernize COCOM's organization and communications;

(f) Recommend that another COCOM High Level Meeting be held in 1983.

Criticism: The United States seems to be considering the use of COCOM for economic sanctions which go beyond the security needs of the COCOM members.

US Response: The United States believes that, in determining the scope of the embargo, COCOM members should carefully review the full spectrum of high technology items because of the military uses of many of these exports. The United States intends to work with the other COCOM members to develop technically precise definitions of those items which warrant control because of their potential impact on the security of the member countries.

FINANCIAL ISSUES: DEBT

I. ISSUE

The large Eastern European and Soviet indebtedness to Western creditors increases Western vulnerability and Soviet leverage over the West. The West must not only cope with existing debt service problems now confronting Eastern European countries like Poland, Romania and Hungary, but also establish restraints on future government-backed credits and credit guarantees to the Soviet Union to moderate, if not hold level, the USSR debt burden, and to put added pressure, at the margin, on resource allocation decisions, particularly as regards the military sector.

II. ESSENTIAL FACTS

Poland's financial crisis has had adverse repercussions on other Eastern European countries, effectively drying up private bank lending and creating a major debt servicing problem in Romania and, most recently, Hungary.

The Soviet Union is also experiencing a severe hard currency shortage, and Soviet medium-term economic prospects look dim as well. Unless the Soviets are able to increase substantially their hard currency exports, they will try to increase borrowing from Western governments and private banks in the next few years to avoid a decline in essential hard currency imports. Consequently, Soviet indebtedness to the West could rise substantially unless restrained by official action.

III. TALKING POINTS

Criticism: Although the Soviet Union is currently experiencing a hard currency shortage, it still remains a good credit risk.

Response: While current Soviet debt service is low in relation to hard currency exports, continued Soviet borrowing at current rates would more than double overall indebtedness by 1985, creating policy problems for the West similar to those now posed by Poland.

We are seeking to develop a mechanism to restrain Western government official credits and credit guarantees to the USSR to avoid giving the Soviets a debt lever to use against us as an easy way out of their financial difficulties.

Criticism: The U.S. position on rescheduling the debt of Eastern European countries is being determined on the basis of political considerations.

Response: Although Poland is an obvious exception, our position on debt reschedulings is determined primarily on the basis of economic and financial considerations.

FINANCIAL SUBSIDIES*

I. ISSUE

How to reduce subsidies in export credits to the USSR.

II. ESSENTIAL FACTS

The USSR receives subsidies through export credits at low interest rates and long terms. We have tried to reduce subsidies in the OECD, but some countries are reluctant to abandon them. They believe subsidies are necessary to maintain exports and employment.

If we continue to subsidize Soviet borrowing, we are acting against our own interest by compensating in part for its economic shortcomings and indirectly supporting its military expenditures. We want to eliminate subsidies by making the USSR pay market rates of interest and shortening the repayment term.

III. TALKING POINTS

Criticism: Official export credits are more important to trade for other countries than for the U.S.

Response:

-- The USSR will still import many of its needs even if it must pay cash or market interest rates.

Criticism: Other countries (Japan) will gain an advantage by still providing low interest credits. The U.S. benefits since its exports to the USSR are grain that does not need credit support.

Response:

-- Low interest rates are offset by other factors such as price, relative inflation rate, and currency risk.

-- (For Europeans) The Japanese have assured us they will follow any restraints we agree to on credits to the USSR.

-- We are talking about subsidies. Our grain exports are not subsidized.

Criticism: The U.S. is seeking its political objectives by commercial means.

Response:

-- It is not in our economic interest to subsidize the USSR.

* This paper will require major revision depending on the results of the OECD export credit meeting May 4-7.

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COUNTERTRADE

I. Issue

Many commercial transactions with communist, and to a lesser extent, developing countries, involve countertrade arrangements, in which exporters in separate but parallel contracts are required to accept products from the purchaser in partial or total payment for the sale. These arrangements, particularly with communist countries, impose unusual costs upon some Western exporters and may add to Western economic vulnerability.

II. Essential Facts

Countertrade arrangements are used by communist and some developing countries as a means to reduce net outflows of hard currency and to facilitate exports of their products without full marketing costs or efforts.

Countertrade imposes on Western exporters added costs of marketing the compensation goods they take as payment. Small and medium sized companies are particularly disadvantaged in competing for contracts involving countertrade. Because of the long-term commitments in major countertrade contracts involving commodities and the unpredictable behavior of world markets, future counterdeliveries may disrupt Western markets.

The US has no legal authority to restrict US companies from engaging in transactions involving countertrade, other than by withholding Eximbank credits in such instances. Multilateral agreement is necessary effectively to discourage countertrade. However, before specific multilateral measures are proposed, we believe further examination of countertrade practices and their effect on markets, prices and companies is necessary. Other OECD members, particularly the Benelux countries, have expressed concern over countertrade.

III. Talking Points

Criticism: Allied governments, although themselves more or less critical of countertrade, may question the importance of this issue relative to other issues being discussed at Versailles.

Response:

-- We are concerned that countertrade demands may impose added costs on our companies and in some cases, may prevent smaller and medium sized companies from engaging in trade.

-- We believe it would be useful for Western governments to analyze further the effect of countertrade flows on markets, prices, and on our private sector.

-- The desirability of achieving multilateral agreement on controlling government credits and credit guarantees for transactions involving countertrade also should be considered.

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DECLASSIFY ON 4/26/88

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Size and Composition of East-West Trade

I. Issue

East-West trade, while a relatively small percentage of summit countries' total trade, is very important for certain sectors of their economies. The Europeans have frequently chided the U.S. for maintaining its high levels of grain sales to the Soviets while asking them to restrict their industrial exports.

II. Essential Facts

In 1980 exports of summit countries to the Soviet Union ranged from $4.37 billion; (2.3% of total exports) for West Germany to $1.5 billion; (0.69% of exports) for the U.S. With the lifting of the grain embargo U.S. sales rose to 2.3 billion or almost 1% of exports in 1981. Comparable 1980 figures for other summit participants are Canada ($1.3 billion; 2.0%); France ($2.5; 2.2%) Italy ($1.2; 1.6%); Japan ($2.7; 2.1%) and the U.K. ($1.1; 1.6%). Except for Japan and Canada, who sell chiefly to the U.S.S.R., exports to Eastern Europe are roughly the same magnitude as to the Soviets.

For all summit countries other than the U.S. and Canada sales of manufactured goods and chemicals accounts for over 75% of exports. Agricultural sales comprise over 70% of total U.S. exports to the U.S.S.R. and Eastern Europe. The majority of Western purchases from the East are raw materials and bulk chemicals, much of which are shipped under compensation arrangements.

East-West trade is likely to grow at a very slow rate during the short to medium term, given Soviet and other East European debt and reluctance of Western financial institutions to extend new credits. The big exceptions to this general rule will probably be for sales related to large Soviet energy projects and feed grain sales to support top priority meat production programs.

III. Talking Points

Criticism: Europeans often argue that the U.S. has asked the Allies to assume disproportionate costs of a tougher stance towards the Soviets. While asking for European restraint on credits, high technology and energy related sales, the U.S. has allowed agricultural sales to the Soviets to use towards previous record levels.

Response:

---Our export control policies have been targeted towards those items we believe make a direct contribution to the enhancement of Soviet war making potential. We have opposed the Yamal pipeline because it would substantially increase the vulnerability of many NATO countries to Soviet pressure.

----It is not our intention to wage economic war with the Soviets. We are not opposed to trade in commodities which do not enhance Soviet military capabilities or increase the vulnerability of the alliance.

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YAMAL PIPELINE

I. ISSUE

The U.S. opposes the Yamal gas pipeline because it will result in increased European dependence on Soviet gas supplies. Our Polish sanctions included expanded export controls which prevented both new sales and the use of previously contracted U.S. equipment for the project.

II. ESSENTIAL FACTS

Since raising the issue at Ottawa last year, the U.S. has repeatedly made clear its concern about the $10 billion pipeline project which will bring natural gas from Siberia to European countries. The project could expose Europe to potential political, and psychological vulerability, and provide the Soviets with a source of up to $8 billion per year to make up for declining oil sales and ease financing of their growing military capability.

The Germans and French have made clear that they intend to proceed with the project in order to diversify their energy sources, and will find alternate sources for U.S. turbine components stopped by our December 29 sanctions. Margaret Thatcher has proposed that the U.S. permit execution of existing contracts for the pipeline in return for European governments taking "comparable measures" to ours.

III. TALKING POINTS

Criticism: The U.S. should lift its export controls to allow execution of pre-existing contracts. U.S. concern about the pipeline is overblown, since net European dependence on Soviet energy will not increase.

Response:

-- We should not be looking to the Soviet Union for major supplies of a vital resource that could be used as an economic and political lever to affect Alliance cohesiveness.

-- U.S. export controls are directed at denying the USSR key technology and equipment in critical areas of their economy.

-- We wish to work together with you in developing alternate energy sources and in limiting vulnerability to Soviet energy leverage, present and future.

-- We are also concerned about subsidized official credits and credit guarantees provided to the Soviet Union, both in connection with the pipeline and more broadly.

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YAMAL PIPELINE AND ENERGY ALTERNATIVES

I. ISSUE

Gas deliveries to the West Europeans from the West Siberian pipeline project will provide the Soviets with leverage over the West Europeans and $8 billion of projected annual hard currency earnings.

II. ESSENTIAL FACTS

The U.S. has opposed this project for the last two years, most directly by President Reagan at the Ottawa Summit last year. This opposition is based on the imprudence of increasing dependence on insure Soviet sources, the irony of investing in Soviet infrastructure while the Free World projects are left without investment and the questionable wisdom of investing billions of subsidized credits in a bankrupt Eastern bloc.

III. TALKING POINTS

Criticism: The project is a fait accompli.

Response:

-- many details to be worked out; many such projects fall apart

-- Italians are "pausing for reflection"; Dutch and Belgians are reconsidering participation as consumers

-- other consumers concerned about level of dependence, falling demand, attractiveness of alternatives

Criticism: Europeans need to diversify energy sources.

Response

There are alternative energy sources available.

Independent analysis indicates that North Sea resources larger and more available than perviously thought.

-- Could displace all the Soviet gas to Europe from the West Siberia project

-- Peak annual production could be increased to twice the Soviet project without reducing current reserves/production ratios

North Sea is only one of several alternatives to Soviet gas.

Drafted by: Dr. [illegible] (EB/ITP? [illegible])
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GLOBAL GROWTH CONFERENCE

I. Issue

The idea of a Global Conference on Economic Growth and Development (G Con) has been raised in internal U.S. Government discussions as a possible alternative to an unacceptable process of Global Negotiations (GN) which would result from most of the ideas now being proposed at the United Nations (UN) in New York. Although no USG decision has been made to pursue this idea, reactions of other Summit participants to such an overture could help us determine whether further internal consideration is worthwhile.

II. Essential Facts

The United States has been resisting proposals for GN which call for negotiations across functional topics, treating substantive economic issues as negotiating chips (e.g., trade, energy, agriculture, development, finance, and monetary issues). We also see the proposed GN central negotiating body as likely to encroach upon the jurisdiction and powers of U.S.-backed international agencies (e.g., the International Monetary Fund, World Bank, General Agreement on Tariffs and Trade). Other industrialized countries, while sharing some of our concerns, favor going forward with GN as a political accommodation to developing countries. They expect to defend their fundamental economic interests during actual negotiations rather than limiting the damage by staying out of a badly flawed process.

The concept of a G Con has been raised in internal U.S. discussions, as a possibility for breaking the impasse and reassert U.S. leadership. A G Con could be a consultative (non-negotiating) forum to address specific economic issues (e.g., inflation), with Finance Ministers doing the talking. Such a Conference would be a logical evolution of the President's concern for developing countries demonstrated at Cancun. It could fill a perceived need for an economic dialogue on a global basis and be used to highlight U.S. economic development policy while encouraging moderate developing countries to engage in practical discussions in existing fora.

On the downside, a G Con would detract from ongoing U.S. initiatives in existing international agencies (e.g., GATT Ministerial), probably renew acrimonious "North-South" bloc politics and rhetorical confrontation, frustrate our thrust of differentiation among developing countries, impede efforts to match concrete problems with realistic solutions (e.g., Caribbean Basin Initiative), subject United States policies (high interest rates, aid budget cuts), to sharp LDC criticism and encourage extraordinary conferences (like GN) outside the established international institutions. LDCs may resist because they perceive a G Con as a ruse to divert them from GN.

III. Talking Points

Criticism: The U.S. has been holding out against GN and souring the "North-South" dialogue.

Response:

-- GN as proposed in New York would undermine the existing international economic system;

-- If an alternative is needed, either to move others away from GN, or to offset recriminations over its failure, a consultative Global Conference on Economic Growth and Development may have some appeal.

-- Such an approach, however, would be difficult to launch and manage, and would risk "snapping back" into GN mode. Do you think such an idea would be worth pursuing?

MDB ISSUES: U.S. CONTRIBUTIONS

I. ISSUE

There may be concern at U.S. funding levels for the "soft loan" windows of the multilateral development banks (MDBs). These windows provide resources on concessional terms to poor countries.

II. ESSENTIAL FACTS

The Administration is requesting $1,537 million in budget authority for the MDBs in FY 1983; this is an increase of $275 million over the FY 1982 appropriation. (88 percent of the FY 1983 request is for soft window contributions.) The request reflects our desire to meet the funding arrangements negotiated by the previous Administration. However, Congressional appropriations ceilings will require the $3.24 billion U.S. contribution to the Sixth Replenishment of the International Development Association be stretched over four years rather than the three envisioned when IDA VI was negotiated.

With regard to the regional MDBs, we expect to participate in new soft loan window replenishments, but there will be a reduction in real terms in the aggregate level of U.S. contributions. We favor emphasizing loan quality, economic policy reforms and a greater concentration of soft lending on the poorest countries; with more creditworthy borrowers shifting to "hard-window" resources (i.e., "maturation").

III. TALKING POINTS

Criticism: Low U.S. funding will reduce MDB lending to the poorest countries.

Response:

-- (Regarding IDA VI): We have asked Congress for $945 million in FY 1983 which is the maximum allowed under authorizing legislation, and will request $1,095 million in FY 1984. This will complete our contribution to IDA VI.

-- (Regarding new replenishments): We have agreed to provide $150 million (over 3 years) to the African Development Fund which is an increase of 20% over the last replenishment, and $520 million (over 4 years) to the Asian Development Fund which is an increase of 17%. We also hope to participate in a new replenishment of the Inter-American Development Bank's Fund for Special Operations. While we expect to participate in IDA VII, we are not yet prepared to begin discussions on funding levels. Our first order of business is to persuade Congress to complete action on FY 1983 funding on IDA VI.

-- Budget constraints underscore the importance of increasing loan quality, and focusing soft lending on the poorest countries. If the more creditworthy of current soft loan recipients are shifted into hard window borrowing there should still be adequate soft lending for those most in need.

LDC ECONOMIC OUTLOOK

I. ISSUE

Are extraordinary measures needed to alleviate the balance-of-payments strains experienced by non-OPEC LDCs since the steep oil price increases of 1979 and early 1980?

II. ESSENTIAL FACTS

The aggregate current account deficit (including receipts of official grants) of the non-OPEC developing countries tripled between 1978 and 1981 (from $23 billion to $70 billion according to OECD figures), while economic growth was cut from over 6% to 3-4%, and inflation rose by one-half (from 30% to 40-50%). We expect the current account deficit to begin to decline in 1982 (some believe it will continue to rise). It may fall to about $55 billion in 1983 if some important LDCs successfully implement recently adopted restrictive economic policies. In 1982 and 1983, we expect some recovery of growth and slowing of inflation. Relatively low foreign exchange reserves and heavy debt service payments will continue to be of concern for some.

III. Talking Points

Criticism: Industrial countries need to act to deal with the low commodity prices and high interest rates which are causing serious balance-of-payments difficulties and low growth in the non-OPEC LDCs.

Response:

-- Enormous OPEC oil price increases in 1979 and 1980 were followed by recession in the industrialized countries, leading to lower commodity prices and weak demand for LDC exports. These factors, all directly or indirectly caused by the OPEC price increases, combined in some cases with poor economic management to create the LDCs' balance-of-payments problems.

-- Lower inflation and more rapid growth in the U.S. and other industrial countries will lower interest rates and improve export markets for the LDCs.

-- Countries with serious balance-of-payments problems must move away from expansionary economic policies toward anti-inflation policies and private sector incentives.

-- An improving world economy and better economic management will certainly strengthen LDC creditworthiness and minimize the incidence of debt problems.

Classified by ____________
☐ Declassify ☐ Review for
Declassification on ____________

POPULATION

I. ISSUE

Historically unprecedented population growth in many developing countries can impede the process of economic and social development. It has serious implications for unemployment, migration, and the health of women and children, it diverts resources from investment to consumption, and it undercuts the effectiveness of foreign assistance. The Ottawa Summit Declaration (para. 20) expressed concern about implications of population growth and pledged "greater emphasis on international efforts in these areas." One or more of the Summit participants may propose similar recognition of the issue this year.

II. ESSENTIAL FACTS

Even allowing for continuing slowdown in the growth rate, world population is likely to increase from the current 4.5 billion to over 6 billion by the year 2000: a growth in only two decades almost equal to the entire world population as recently as 1930. Some 90 percent of this growth will occur in low-income countries, many of which will double their population in only two to three decades. The proportion of industrialized countries' population in the world total, which was one-third in 1950, is likely to decline to only one-fifth by 2000.

Population is not a North-South confrontational issue, nor is it as sensitive politically in LDC's as it once was. Many LDC's have made voluntary family planning programs a national priority, and requests for assistance in this area now far exceed currently available multilateral and bilateral resources.

The U.S. has been a leader in providing population assistance abroad, and in biomedical research into better and safer methods of family planning as well as solutions to problems of infertility.

III. TALKING POINTS

Possible Foreign Point: Because of the importance of population, we should acknowledge it again in our deliberations.

Response:

-- We would welcome language noting the importance of appropriate policies for economic development and for public health. In the implementation of these population policies, the principles of voluntarism, free choice, and concern for human dignity should, of course, be stressed.

OVERVIEW: ENERGY

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objective

The energy discussion at the Versailles Summit will give us an opportunity to reassure our Summit partners of our strong commitment to cooperation in international energy matters.

Supplementary Objectives

-- to underscore the importance and effectiveness of primary reliance on market forces in encouraging development of energy supplies and more efficient use;

-- to encourage Summit countries to fully develop, on an economical basis, the rich resource base of the community of Western countries, thereby reducing dependence on insecure sources of supply; and

-- to continue efforts to minimize the disruptive effects of oil and gas shortfalls and/or cutoffs from less reliable exporters.

Initiatives

Building from the base created by U.S. reassurances, we should then seek a renewed commitment on the part of Summit nations to:

1. Accelerate development on an economical basis of the abundant energy resources of our own countries.

2. Continue and reinforce our market-oriented policies which will increase energy efficiency and promote structural adjustment to break the link between economic growth and oil consumption, recognizing that these twin goals are most efficiently and expeditiously achieved by market forces.

3. Expand nuclear energy, encouraging greater public acceptance by responding to concerns about safety, waste management and non-proliferation;

4. Take steps to realize the full potential for the economic production, trade and use of coal;

5. Develop to the fullest extent possible sources of renewable energy.

We should urge other summit nations to:

6. Expand Western natural gas production and trade, thereby minimizing dependence on insecure sources of supply and providing economic opportunities within the West;

7. Seize the opportunity provided by a weak oil market to build up levels of strategic oil stocks, strengthening our capacity to minimize the disruptive effects of oil and gas shortfalls and/or cutoffs; and

8. Strengthening the market by:

-- Reducing over time restrictions on the trade of various energy fuels among Western countries;

-- allowing domestic energy prices to reflect international levels;

-- removing impediments to the free flow of capital investment funds; and

-- dismantling internal subsidy systems which make one form of energy artificially more attractive to consumers and thus distort market signals.

II. BACKGROUND AND PRE-SUMMIT PREPARATIONS

Our summit partners see the U.S. as richly endowed with coal, oil and natural gas. Generally more dependent on imported energy than we, they seek reassurance that we want Summit country cooperation in energy matters, that we would cooperate with them if another oil crisis arose and that, not withstanding our opposition to their planned purchases of oil from the USSR and to the Soviet gas pipeline, we are interested in working with them to develop secure and reasonably priced sources of energy.

III. OTHER COUNTRY OBJECTIVES AND STANCE ON U.S. OBJECTIVES

We expect the Europeans to bring up high interest rates as a major obstacle in achieving greater levels of exploration and production of oil and gas; investments in coal conversion and coal handling facilities; and funding of research and development in new and renewables. In any discussion of coal, they will probably comment on what to them appears to be a reluctance by the U.S federal government to aid and finance infrastructure to facilitate U.S. coal exports. Our failure to introduce legislation accelerating deregulation of gas prices may be criticized, as well as slowdown of construction of nuclear power facilities in this country.

Canada: Will seek to reduce the amount of attention given energy at the Summit, utilizing a damage limitation strategy. Trudeau will try to head off criticism of Canada's government-imposed impediments to energy investment and low oil prices. From the Canadian view point, Canada adheres as closely as any Summit country to the general energy principals agreed to at earlier Summits.

France: Mitterrand will want language in the communique condemning (U.S.) high interest rates and supporting the World Bank Energy Affiliate (For a discussion of LDC energy, see the paper on North-South issues). France imports more coal than any other country in Europe and will push for a greater U.S. commitment to dredging deeper coal ports. The French Government has, since World War I, played the key energy role in France. The state owns the oil companies and it controls the energy market. There are price controls and subsidies to French coal; thus discussion of market forces will fall on uncomprehending ears. France does have an enviable record of energy efficiency and has made remarkable progress in nuclear power. We can expect Mitterrand to stress these areas. France is interested in natural gas security but sees this principally in terms of pressing for greater Dutch, Norwegian and UK efforts. Mitterrand's economy badly needs the Soviet pipeline contracts for jobs in the depressed steel industry. Although France is not a member of the IEA, it cooperates in IEA efforts through membership in the European Community.

FRG: The Germans believe considerable progress has been made in achieving structural change away from oil in our economies and that at the moment there are no pressing problems that require emphasizing energy at the Summit. Schmidt will defend the German-Soviet natural gas agreement on grounds that gas backs out oil, thereby reducing dependence on insecure imported oil. He will contend that German gas companies have already taken the steps necessary to cope with possible gas supply interruptions. Germany maintains a system of coal import quotas and subsidizes domestic coal production and, therefore, may be expecting U.S. comment on these practices. We believe Chancellor Schmidt will join others in pressing the U.S. on interest rates.

Italy: May join in attacking the U.S. on interest rates. Italy may also wish to discuss natural gas. The Italians may criticize the recent French contract subsidized by the French Treasury giving Algeria a very high price. Italy seeks a formal, structured international system to handle minor oil supply disruptions. The U.S. has successfully resisted on the grounds that every oil crisis differs and interventionist systems set up in advance will not work, but we have emphasized willingness to consult and cooperate in case of crisis. We have pointed out that if Italy's state system of oil pricing were abolished, the Italian consumer could respond quickly to changes in price and supply, mitigating the effects of supply shortfalls.

Japan: Japan relies on Summit and International Energy Agency declarations to justify politically unpopular domestic policy actions. Japanese attitudes are shaped by dependence on imported oil for 70 percent of their energy. The Japanese may ask the U.S. if dismantlement of the Department of Energy is intended to signal that the U.S. believes the energy crisis is over. They may also press for a greater U.S. commitment to aid other nations in case of a small oil supply disruption. In any discussion of increasing coal imports, Japan may respond that the U.S. first needs to undertake coal port dredging. Japan is somewhat vulnerable to criticism on lack of progress in nuclear, although Japan can point to snags in nuclear cooperation (e.g., approval for reprocessing) for which they hold U.S. procedures responsible. Suzuki may seek assurances that cooperative energy R&D programs will not be scuttled by budget cuts.

United Kingdom: As the only net oil exporter in Europe and a country with considerable natural gas production, the UK will be wary to pressure of accelerate exploration, production and export of UK oil and gas. Mrs. Thatcher may be expecting U.S. criticism of high marginal tax rates on North Sea oil production and a constantly changing tax system that oil companies contend limit attractiveness of new energy investment. She may also expect us to mention UK subsidized coal, which when exported competes with non-subsidized U.S. coal. On pricing of energy, Mrs. Thatcher could raise gas deregulation in the U.S. The UK has spearheaded a drive in the EC (European Community) and the International Energy Agency for greater transparency in energy pricing, aimed at government-administered price regulations and controls in Canada, Italy, France and Japan, and has criticized the FRG for low electricity rates to German industry.

European Community. The principal objective of the President of the EC will be to protect the interests of EC nations not at the summit and to raise issues which concern these nations, e.g. interest rates, coal port dredging, and deregulation of natural gas prices.

IV. DISCUSSION OF OBJECTIVES

-- I WANT TO EMPHASIZE AT THE OUTSET OUR FIRM ATTACHMENT TO CLOSE COOPERATION WITH OUR SUMMIT PARTNERS IN INTERNATIONAL ENERGY MATTERS.

-- WE REMAIN MINDFUL OF ENERGY SECURITY CONCERNS OF THOSE MOST VULNERABLE TO OIL SUPPLY DISRUPTIONS AND WILL WORK IN THE INTERNATIONAL ENERGY AGENCY TO IMPROVE OUR PREPARATION FOR OIL SUPPLY INTERRUPTIONS.

-- WE, THEREFORE, TAKE THIS OCCASION TO REAFFIRM THE COMMON OBJECTIVES OF THE DECLARATION OF THE OTTAWA SUMMIT.

-- WE SHOULD ASSURE THAT MARKETS GIVE APPROPRIATE INCENTIVES FOR EFFICIENT EXPLORATION AND PRODUCTION OF ENERGY RESOURCES IN ORDER TO TAP THE ABUNDANT ENERGY RESOURCES OF OUR OWN NATIONS.

-- WE SHOULD COMMIT OURSELVES TO REMOVING MARKET IMPEDIMENTS, OBSTACLES TO ENERGY INVESTMENT AND ENERGY TRADE, AND SHOULD ALLOW DOMESTIC ENERGY PRICES TO REFLECT INTERNATIONAL LEVELS.

-- WE BELIEVE ENERGY SECURITY IS DIRECTLY LINKED TO MAINTAINING HIGH LEVELS OF STRATEGIC RESERVES. WE INTEND TO CONTINUE PURCHASES FOR OUR STRATEGIC PETROLEUM RESERVE AND ENCOURAGE OUR SUMMIT PARTNERS TO DO LIKEWISE AT THIS OPPORTUNE MOMENT IN THE OIL MARKET.

-- FROM OUR PERSEPCTIVE, IT IS ABSOLUTELY IMPERATIVE THAT WE ASSURE THE HEALTHY GROWTH OF NUCLEAR POWER IF WE ARE TO ACHIEVE A BROADER ENERGY MIX IN THE DECADES TO COME.

-- WE URGE SUMMIT COUNTRIES TO WORK WITH SECURE SUPPLIERS TO DEVELOP WITH UTMOST URGENCY THE MEANS TO ACHIEVE ENHANCED GAS SECURITY AND TO MINIMIZE DEPENDENCE ON GAS FROM THE SOVIET UNION.

-- AS COAL IS THE MOST ABUNDANT ENERGY RESOURCE IN THE WEST, WE WANT TO EMPHASIZE THE SIGNIFICANT PROGRESS THE U.S. HAS MADE IN THE DEVELOPMENT AND SHIPPING OF U.S. COAL. WE URGE CONSUMING COUNTRIES TO JOIN THIS EFFORT THROUGH SIGNING VIABLE LONG TERM CONTRACTS AND JOINT INVESTMENTS.

-- IN THE NEW AND RENEWABLE ENERGY FIELD, SUMMIT COUNTRIES SHOULD IDENTIFY OPPORTUNITIES FOR SHARING EXPENSES AND EXPERTISE IN THOSE HIGH RISK TECHNOLOGIES WITH TOO DISTANT A PAYBACK PERIOD TO INTEREST PRIVATE INVESTORS.

Key Issues Paper: European Energy Supplies

I. Statement of the Issue

Western Europe is currently dependent on non-European sources for about 50 percent of its energy needs, a situation that will continue for the foreseeable future.

II. Essential Factors

Although overall dependence is high, it varies significantly between fuel types.

- o Oil consumption accounts for 55 percent of European energy use. Nearly 85 percent of the oil is imported. OPEC supplies approximately 80 percent of total imports, while the USSR supplies an additional 10 percent.

- o Coal consumption accounts for about 20 percent of European energy use. Approximately 20 percent of the coal consumed is imported, with the United States accounting for about 40 percent of total imports. Coal's share in total energy consumption is expected to rise and imports are likely to increase by 1990.

- o Natural gas consumption accounts for about 15 percent of European energy use. Currently only about 15 percent of the natural gas consumed is imported, two-thirds of which comes from the USSR. By 1990, however, the USSR will supply more than 20 percent of Europe's gas needs.

- o The remaining 10 percent of European energy needs are primarily met through domestic hydroelectric and nuclear power.

III. Key Points

Point: West Europeans have made substantial progress in diversifying energy sources to reduce dependence on foreign oil supplies.

Counterpoint: Although progress has been made, dependence on imported energy remains very high. Energy policy must continue to focus on developing alternative sources of supply and diversification away from unreliable or insecure suppliers.

- o Development of North Sea natural gas reserves could obviate the need for any additional purchases of Soviet gas in the 1990s.

- o Algeria, Nigeria and Cameroon could provide significant additional volumes of gas by the early 1990s if European market conditions are favorable.

- o OECD coal exporters are in a position to meet their own growing requirements and the import needs of Western Europe.

- o Nuclear energy needs government support while falling real oil prices may require the government to encourage development of other non-oil energy sources.

Point: The Soviets have proven to be a dependable source of supply. Hard currency needs will further encourage uninterrupted supplies of gas and oil.

Counterpoint: Soviet gas supplies to Western Europe have been interrupted on several occasions for technical or other reasons. Increased imports from the Soviet Union also open the possibility of political pressure and supply restrictions should Moscow believe such actions would prove beneficial.

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U.S. SUPPLY DEVELOPMENTS

DRAFT

I. Administration Policy and U.S. Energy Supply

The positive response of U.S. petroleum markets to the immediate decontrol of oil decision in January 1981 strongly supports the free-market approach to energy policy advocated by this Administration.

II. Essential Factors

Decontrol of oil and removal of the Entitlements Program eliminated subsidies for U.S. oil consumption and oil imports and encouraged domestic oil exploration and production. Lower U.S. oil imports, resulting from decontrol, contributed to lower demand for OPEC oil and lower world oil prices. Most foreign governments strongly support the decontrol decision.

III. Key Points

Since decontrol in January 1981, U.S. oil drilling activity has been at an all time high, domestic oil production remained flat instead of declining at over 200 thousand barrels per day as previously expected and world oil prices fell by over $4.00 per barrel and gasoline prices by about 14 cents per gallon.

Point--The improvements in the U.S. oil market result more from the doubling of world oil prices in 1978/79 rather than the decontrol decision.

Counterpoint--The oil price increases in 1978/79 created a high potential motivation for action. Oil decontrol released that potential by allowing consumers and producers to see actual prices.

Point--The Reagan Administration decontrol decision only speeded up what was already well underway from the Carter Administration.

Counterpoint--President Carter deserves a lot of credit, but the Reagan Administration's forceful move to decontrol oil and clearly stated objective of allowing markets to work eliminated any doubt about the possibility of future price controls and so allowed producers to invest now in drilling and production activity knowing that free-market prices would prevail in the future.

Point--While decontrol may have helped increase conventional oil production, low world oil prices are slowing down investment in U.S. synthetic fuels.

Counterpoint--Lower energy prices coupled with our expected improvement in interest rates and inflation are lowering the projected costs of synthetic fuels. Also, the Synthetic Fuels Corporation is moving ahead with loan guarantees and other programs to insure some synthetic fuels development so that if world oil prices rise in the future, private industry can rapidly expand synthetic fuels production as needed.

John Stanley-Miller/PPA/DOE/252-5388

STOCKPILING

I. Issue:

The United States has emphasized on numerous occasions that primary reliance on market forces together with high levels of strategic stocks for discretionary national use are the best means for dealing with future oil supply disruptions of whatever proportion. The United States has remained strongly opposed to any formal stock drawdown arrangement coordination, such as that proposed by Italy and France, to counter the effects of minor supply disruptions. These same countries have attempted to link discussions of increasing stock levels with those of stock use, and in the past advocated utilizing flexible surge stocks to reduce pressive on the market in minor supply disruptions.

II. Essential Facts:

At the February 26 meeting of the IEA Governing Board, the U.S. delegation successfully won IEA support for remanding all stock issues to one of the IEA subgroups for further consideration, where we hope to discourage further stock use initiatives. At the same meeting, the United States successfully eliminated the stock issue as topic for the IEA Ministerial in May. While we continue to support high levels of oil stocks we remain strongly opposed to discussion which would link stock levels and stock use.

III. Talking Points

Criticism: Relatively minor oil disruptions can have dramatic consequences for individual countries supply positions and for over all price levels. Nonetheless there is no system which addresses stock management in these situations.

Response: The U.S. has continuously stressed that primary reliance on the market together with high levels of strategic stocks for discretionary national use are the best means of dealing with oil disruptions of either sub-trigger or emergency proportions. Formal interventionist mechanisms interfere with the effective operation of the market and for a variety of legal and technical reasons would be impossible to establish and administer effectively in a sub-trigger environment.

Criticism: Supply interruptions similar to those of 1979, may be beyond the resources of private oil stocks for an individual country, and yet be below the level that would trigger the IEA sharing system

Counterpoint: It is impossible to anticipate the special characteristics of an oil supply disruption. Therefore, we must build government emergency oil stocks to supplement private supplies and be prepared at the time of a supply interruption to consult closely with industry and other governments and to take whatever action is judged necessary. However, emegency and other security stocks shuld be available for use on a discretionary basis by national governments as they see fit.

OIL PRICE TRENDS/OUTLOOK

I. ISSUE

- Recent decline in world crude oil and refined product prices.
- The outlook for oil prices in the future.

II. ESSENTIAL FACTS

The world oil market has been extremely weak in 1982. Oil consumption has continued its steep decline which began in 1979. At the same time, oil exporting countries have been producing more oil than they could sell. The resulting over-supply has put pressure on prices, forcing oil producers either to give official and/or unofficial price cuts as most non-OPEC and some OPEC oil exporters have done, or to cut production as OPEC did beginning April 1, 1982.

The decline in oil prices can be attributed to both a long-term, essentially irreversible trend toward a more efficient utilization of energy and non-oil alternatives and a cyclical downturn in the economic performance in the industrialized countries. The U.S. position is that the upturn in economic performance beginning later this year is unlikely to reverse the trend, resulting from OPEC's past overpricing practices and U.S. decontrol toward lower oil consumption through improved energy efficiency and greater use of non-oil alternatives such as coal and nuclear. In the absence of an unexpected supply disruption, there should be little or no upward pressure on real oil prices for the next several years.

III. TALKING POINTS

Point: Low economic activity has been primarily responsible for the decline in oil consumption, and as a result, when the economic recovery arrives oil consumption will increase, renewing upward pressure on prices.

Counterpoint: Past overpricing of oil by OPEC and this Administration's reinforcement of market forces through decontrol of crude oil prices and deregulation of the U.S. oil industry have been the driving forces behind the trend toward greater efficiency in energy useage and uses of alternatives to oil in the U.S. This Administration's market-oriented policies will offer American consumers the proper incentives to continue to become more efficient in their use of energy and to use alternatives to oil, thus perpetuating an essentially irreversible trend toward lower oil consumption. This process will also receive a boost from Administration policies to stimulate economy recovery, which will also encourage new energy-efficient capital investments.

NATURAL GAS - PRICING AND SUPPLIES

I. ISSUE

- Deregulation of U.S. wellhead natural gas prices.
- European dependence on Soviet gas imports.

II. ESSENTIAL FACTS

The European Community is concerned about the U.S. commitment to the accelerated decontrol of domestic natural gas prices. They fear that continued controls will increase U.S. demand and reduce production and force the U.S. to draw more heavily on international gas markets. This concern has been heightened by the decision to defer legislation to accelerate natural gas deregulation.

In addition to the current commitments being made to increase Soviet natural gas imports, Europeans are considering the possibility of another increment of Soviet gas in the late 1980's or early 1990's. The U.S. position is to encourage the Europeans to develop alternative sources, especially new Norwegian gas supplies. The U.S. would like to demonstrate that the security provided by alternative sources outweighs the additional cost.

III. TALKING POINTS

Point: The U.S. Administration appears to have reconsidered its commitment to proceed with accelerated deregulation of natural gas prices.

Counterpoint: Due to an extremely heavy legislative calendar, we were forced to defer introduction of legislation to modify and improve the manner in which the Natural Gas Policy Act achieves deregulation of the wellhead price of natural gas. We remain firmly committed to the principle of introducing market forces to our energy markets, including the pricing of natural gas.

Point: Natural gas from the Soviet Union provides Europe with a reasonably priced source of energy to use in the reduction of dependence on Middle East oil.

Counterpoint: In estimating the cost of gas, Europe must consider the cost, in terms of their own security, of dependence on the Soviet Union. More consideration must be given to the development of secure sources of gas supply such as gas from Norway.

NUCLEAR ENERGY

I. ISSUE

Strong support from Summit leaders of commercial nuclear energy as an alternative to reliance on insecure oil would help alleviate some of the problems associated with increased nuclear energy use. One major public concern is waste management which could be specifically addressed in the context of increased international technical cooperation.

II. ESSENTIAL FACTS

The US nuclear industry has experienced cancellation of some 90 reactors since 1978 and has no current prospects for new domestic orders. The major US problems are: 1) reduced rate of growth of electricity demand; 2) utility financial problems; 3) burdensome regulations and licensing delays; and 4) failure to adequately resolve the waste management issue.

Most Western countries, with the exception of France, are experiencing similar reductions in planned nuclear growth, although not necessarily for all of the same reasons. In particular, all Western countries have some degree of a public perception problem associated with high-level waste disposal. Most technical experts would agree that the technology for such disposal in a safe manner is in hand, but the political and institutional decisions necessary to implement it have not been made. Given this situation, nuclear energy prospects in these countries would undoubtedly be enhanced and confidence renewed if Heads of State made a strong statement in support of Nuclear Energy, and recommended some action to resolve the public concern about waste. In the latter regard the Heads of State could ask the OECD Nuclear Energy Agency (NEA) to assess the feasibility of a joint international waste management project.

III. TALKING POINTS

Point: It is important that all energy sources, including nuclear energy, be utilized to their fullest potential to minimize future demands on insecure oil and gas sources.

Response: France may press for a stronger pro-nuclear statement.

Point: In view of widespread public concern over the nuclear waste issue the OECD/NEA should be asked to assess the feasibility of an international waste management project.

Response: Some European countries may suggest that this be omitted as past efforts to define such a project on a scale that would have public impact have been unsuccessful.

Point: We support a Summit mandate to the High-Level Monitoring Group to devote special attention to nuclear energy issues over the next two or three years.

SUMMIT COAL ISSUES

Issue: Consistent with our belief that coal is key in reducing the industrialized countries' dependence on insecure sources of energy supplies, the U.S. objective is to highlight actions necessary to promote coal use, production, and trade. These actions include: (1) signing long-term contracts to induce investment in new mines, rail transportation, and new port capacity, (2) allowing the operation of market forces by reducing and/or eliminating trade and price barriers which restrict coal imports, and (3) encouraging oil-to-coal conversions in the industrial and electrical sectors.

Essential Factors: The economic recession coupled with the soft oil market have temporarily halted the widening of the price differential between coal and oil thereby deflating coal demand. In addition, some Summit countries still pursue trade policies which in effect restrict coal imports, thus resulting in continued dependence on oil. These events threaten to stall or even reverse the progress made to date, slowing the shift to alternatives, discouraging investment necessary for structural change, and jeopardizing the future supply security. The IEA doubts that the Venice commitment to double coal production and use can now be met.

The President's Coal Export Policy Statement illustrates the U.S. commitment to increase coal production, use, and trade. While our Summit partners have dramatically increased their use of steam coal in the last several years, more could be done to facilitate the use of coal in their countries for the long term. Coal production in the UK and Germany is subsidized. Germany restricts imports of coal from non-EC countries by quotas and the UK through a "Buy National" policy. Italy's fuel prices remain controlled thus limiting needed capital for planned coal plants and ports. ATIC, the French coal importing monopoly, gives preference to French-owned coal production. The Japanese Government has requested its utilities to burn additional quantities of heavy fuel oil which are in excess because of the economic slowdown.

Point: If the U.S. wishes to see greater coal exports, it must expedite port development and inland transportation systems to make prices more competitive and reduce bottlenecks.

Counterpoint: Firm long-term commitments from foreign buyers are necessary in order to create a market environment conducive to continued investment in necessary facilities.

Counterpoint: Moreover, the railroads have developed an advanced ship reservation system whereby vessels can preregister for their place in line and loading dates.

Point: U.S. harbors should be dredged to accommodate larger vessels, thus leading to smoother port operation and correcting a major obstacle to coal trade with the U.S.

Counterpoint: The resolution of the port dredging issue is not necessary to smoother port operation; expansion of handling capacity will be sufficient.

Counterpoint: While the U.S. did experience a bottleneck at its leading east coast coal ports in 1980, private industry responded quickly with an estimated $1 billion investment program to expand port capacity over the next 5 years.

OVERVIEW: TECHNOLOGY

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objective

The principal U.S. objective is to achieve a political commitment to examine the growing problem of government interventions affecting trade and investment in high-technology goods and services. It is strongly in the U.S. interest to ensure that US exports have access to the markets of our major trading partners and competitors as well as access to civilian technology. High-technology industry is the backbone of U.S. industrial development and industrial export potential.

Initiatives

The USG has proposed that high-technology trade problems be placed on the agenda for the GATT Ministerial in November, and that the Ministerial launch a work program in the GATT to identify barriers to high-technology trade in goods and services and determine specific steps needed to deal with these problems.

At the OECD Ministerial the United States will support the Secretary General's proposals for an OECD work program to review policies and practices that affect trade and investment in high-technology goods and services, and to prepare a coordinated industrial country position for the GATT review.

II. BACKGROUND AND PRE-SUMMIT PREPARATION

The United States is the leading exporter of high technology goods and services, and we want to press for removal of present barriers to U.S. exports and prevent the erection of any future barriers. OECD countries and the newly industrializing countries view advanced technology industries as critical to their economic growth and international competitiveness. As a consequence many foreign governments are beginning to adopt policies and practices to promote the development of these industries in ways that can distort international trade in high technology products and services. These distortions could lead to retardation of world economic growth and limit the ability of industrialized countries to adjust to increased imports in other sectors.

The USG has already proposed inclusion of issues affecting high-technology trade on the agenda for the November GATT Ministerial, and is developing a detailed proposal for a work program. A cable has been sent to U.S. embassies in GATT member countries asking posts to seek support for GATT discussion of this issue.

The USG supports the OECD Secretary General's proposals for work on high technology, and will indicate strong support for an OECD work program at the OECD Ministerial. We have already begun to discuss these issues and proposals with our industrialized trading partners, and can reinforce these efforts at the Summit.

III. OTHER COUNTRY OBJECTIVES AND STANCE ON U.S. OBJECTIVES

Japan and France have indicated interest in discussing high technology in multilateral fora. Many countries, developed and developing alike, consider the establishment of high-technology industries a matter of national economic and security policy. Some may perceive efforts by the USG to liberalize trade in high technology as contrary to their domestic economic and industrial growth policies.

France has circulated a paper on Technology, Economics, and Employment that reflects the priorities and policies of France's socialist government. The paper proposes a "technological new deal" that includes a coordinated international program of basic research, including North-South technological cooperation, and the standardization of data exchanges. It also proposes that technology be used to promote employment by establishing an international program of education and training in new technologies, an international research program on the problems of working conditions, and a process of harmonization of working conditions. Although this is not the direction in which the United States is moving, there may be some aspects of this proposal that could be of interest. However, we should see that the focus of the dialogue remains on trade and investment liberalization.

IV. DISCUSSION OF OBJECTIVES

Objective: achieve political commitment to examine trade and investment in high-technology goods and services.

Talking Points:

-- Advanced technology will be a significant source of economic growth and productivity for all our economies in the 1980s if we work together to ensure that our governments adopt policies to promote vitality and competition and resist protectionism and other trade-distorting measures.

-- We have proposed that the GATT Ministerial address this issue in its November meeting with the goal of adopting a program to identify and recommend solutions for problems affecting trade in the high-technology sector. Your active support will be necessary to make this effort a success.

-- The OECD should have a lead role in assisting us to develop a program to promote the healthy growth of high-technology industry. The USG supports an OECD work program along the lines suggested by the Secretary General. An OECD program will provide the necessary support as we move toward a GATT work program.

-- In order to provide leadership and support for trade liberalization initiatives I suggest that we include in the Communique of this meeting a statement indicating the importance we attach to maintaining an open trade environment for growth in the high-technology sector.

-- (If Raised) -- We question whether the options raised in the French paper on <u>Technology, Economics, and Employment</u> are priority issues that will best promote the growth and development of high-technology industry. These proposals are very complex in their implications and we suggest they be studied in appropriate OECD Committees.

U. N. CODE ON TECHNOLOGY TRANSFER

I. ISSUE

The impetus for an international code of conduct on the transfer of technology came from developing countries (LDCs). This code has been under negotiation since 1975.

The LDCs believe that a Code will promote the international flow of technology necessary for their development, whereas developed countries argue that many LDC proposals challenge usual commercial practice and would produce a code which actually would deter the transfer of technology or make it more expensive.

II. ESSENTIAL FACTS

Although perhaps three-quarters of the text of a proposed Code is agreed, the most difficult issues remain unresolved. These include the binding versus voluntary nature of the code, its applicability to intra-state transactions, treatment of corporate parent/subsidiary relationships, and the nature of the obligations to be undertaken by private parties to technology transfer transactions. Many of these problem issues involve proprietary technology, including mandatory transfers of such technology.

The U.S. can support a Code which will promote the transfer of technology on a mutually-beneficial basis consistent with sound commercial practice. To accomplish this, the code must consist of voluntary guidelines appropriately balanced between the rights and obligations of companies and governments. The Code should endorse protection of industrial property rights and the freedom of contract negotiations, and be consistent with legal standards and practices commonly recognized among developed countries.

III. TALKING POINT

Criticisms: The Transfer of Technology Code is an important element in the North/South dialogue and the U.S. should be more flexible and sensitive to the needs of developing countries for technology.

Response: The U.S. strongly supports the North/South dialogue, as was symbolized by our participation in the Ottawa and Cancun summit meetings. The U.S. points out that most technology is in private hands and that the majority of transfers of technology are made by private enterprise through normal commercial arrangements such as licensing or direct investment, responding to market forces. The U.S. firmly believes that to be effective a Transfer of Technology Code must recognize this and contribute to a stable economic environment conducive to such commercial activity and not attempt a misguided political solution.

PARIS CONVENTION

I. ISSUE

The Paris Industrial Property Convention (patents and trademarks) is the major worldwide convention in this field. It is very important for the numerous foreign industrial property rights of U.S. industry since it establishes international norms for their protection (e.g. national treatment).

Two sessions of a Diplomatic Conference to revise the Paris Convention have been held (1980 and 1981), and a third session is to be held in October 1982.

Developing countries would like to add new provisions to the Paris Convention for their special benefit, presumably to stimulate the flow of technology essential to their economic development. Some of these provisions would adversely affect U.S. rights.

Developed countries (i.e. market economy), other than the U.S., apparently are willing to make certain changes in the Paris Convention which the U.S. does not regard as acceptable in terms of U.S. industrial property interests.

II. ESSENTIAL FACTS

Developing countries are attempting to gain preferential licensing rights for foreign patents (e.g. a license for exclusive use of a patent in a particular country if the patent holder is not manufacturing the product in that country). Developed countries, other than the U.S., have indicated their willingness to accede to these demands for preferential rights because they fear that developing countries may withdraw from the Paris Convention if their demands are rejected.

The U.S. believes that such revisions will lead to an erosion of industrial property protection provided by the Paris Convention without any significant benefits to developing countries.

III. TALKING POINTS

Criticism: The U.S. hopes that other developed countries will examine carefully all proposed revisions of the Paris Industrial Property Convention for the benefit of developing countries and oppose those such as exclusive-compulsory licenses which would lower the level of protection.

Response: Western European countries are willing to make concessions to developing countries in order to minimize the possibility of their withdrawal from the Paris Convention and because these concessions may not have a significant adverse effect on technology transfer.

OVERVIEW: POLITICAL ISSUES

I. US OBJECTIVES AND INITIATIVES

Principal US Objectives

Stress the fundamental political unity among the Summit nations -- both because of their shared values and because of the link to the NATO Summit.

Underscore your major political concerns, with particular emphasis on East-West relations.

Supplementary Objectives

Give your views on effective cooperative approaches to other crisis areas (such as the Middle East and Central America/Caribbean).

Support a peaceful settlement on the Falkland Islands.

Present your views on Law of the Sea (LOS), terrorism and nuclear non-proliferation, as appropriate.

II. BACKGROUND AND PRE-SUMMIT PREPARATION

In pre-Summit consultations, we have noted our interest in political talks at Versailles. Political and economic issues are inevitably intertwined. The Versailles talks will set the tone for Bonn. And, the presence of Japan and the European Community provides added impact.

While we have pressed for political consultations at past economic Summits, we have stressed our interest in informal political discussions at Versailles so as not to detract from the formal political discussions at the NATO Summit in Bonn. We have therefore not favored a formal agenda for Versailles, although we have indicated our interest in discussing East-West political issues as a backdrop to discussion of East-West economic issues; others may want to discuss topical regional and other questions. We have also favored issuance of an agreed statement on political issues by President Mitterrand, as meeting chairman, a procedure which worked well at Ottawa. Failure to agree on a consensus statement could leave the French latitude to make statements contrary to US interests.

III. OTHER COUNTRY OBJECTIVES AND STANCE ON US OBJECTIVES

All Summit participants favor holding political discussions. For that reason, the French hosts have arranged for such talks to be held at two dinners and a luncheon for heads of government. (We are seeking participation by Foreign Ministers in the luncheon.)

There is considerable similarity of view on East-West political issues (if not on East-West economic questions), although Schmidt may be somewhat more cautious than the others. A preliminary discussion before Bonn of arms control (INF, START) will be an integral part of the East-West discussion. The Japanese will be particularly interested in getting their views on the record before the NATO Summit. If the Falkland Islands issue is still alive, Thatcher will seek Summit support for the UK approach. The Europeans and Japanese will want to hear how the Middle East peace process will continue after the return of the Sinai, with special attention to the Palestinian issue. There will be skepticism about US policy in Central America, but interest in the Caribbean Basin Initiative and economic and social development in Central America/Caribbean. The EC and Japan are increasing assistance to the area and are following closely the Nassau Four deliberations. Those not participating in the Contact Group (Spadolini, Suzuki) will be interested in progress on Namibia and the situation in southern Africa. Japan has been concerned about the strategic implications of our difficulties with China over arms sales to Taiwan; all will be interested in the Vice President's trip to China. Japan will also be particularly concerned about the situation in Southeast Asia.

In addition to discussion of East-West issues and regional crises, there will probably be interest in several global issues. Several Western states have joined us in seeking changes in the LOS draft treaty, but fear that the negotiations could collapse if we press too hard. EC members have been reluctant to be particularly vigilant on nuclear dealings with Middle East countries, as we have suggested. There will be general interest on progress made on terrorism since the Ottawa Summit.

IV. DISCUSSION OF OBJECTIVES

Summit Linkage. The tone of the Versailles Summit political discussion will inevitably affect the Bonn Summit deliberations.

-- Goal at Versailles should be to reaffirm Western unity on major political issues. Chairman's summary is thus most important.

East-West Political Issues. Although much of the concrete work on East-West issues will be covered during the economic talks (credit restrictions, gas pipeline), we want to maintain the political pressure on the Soviets because of their irresponsible international behavior. We also need to balance this approach by emphasizing our sincere commitment to arms control negotiations.

-- US seeks more stable and constructive relations with Soviets; basis for progress in East-West relations is mutual restraint.
-- We must continue to press Soviets to behave responsibly in respect to regional conflicts; firmness is most effective tool.
-- INF talks are underway. We will soon begin START negotiations. Will pursue these negotiations seriously, stressing need for substantial reductions on both sides and constraints on most destablizing systems.
-- Western response to Poland showed Soviets we will not conduct business as usual when Soviets flout Helsinki obligations.

Situation in Poland remains volatile; we must remain alert and ready to take necessary actions if situation deteriorates.
-- Afghanistan Day was a success. Need to keep Soviet occupation in forefront of world opinion.

Regional Issues. As these issues are raised, we should stress that the Camp David process is continuing after the return of the Sinai, and that the efforts of all are needed to keep Lebanon from blowing up, with incalcuable implications for the peace process in the region. On Central America/Caribbean, we should stress regional involvement to encourage support for economic and social progress and for democratic development and regional security.

-- A major objective of this Administration is continuation of Mideast peace process. Pledge to continue to work closely with involved parties.
-- All need to do utmost with Israelis, PLO and internal Lebanon factions to maintain ceasefire and encourage support for a constitutional process. A major blow-up would be catastrophic.
-- Have noted EC and Japanese agreement to increase assistance to Central America/Caribbean. Need to coordinate our developmental efforts in the area.
-- Hope a full, peaceful settlement will be reached soon on Falkland Islands issue.
-- Slow progress being made on Namibia; we believe settlement is possible. Must not lose sight of need to bring South Africa along.
-- Tension has developed in our relations with China over arms transfer policy to Taiwan. We are making major effort to work out solutions.
-- Should continue to support ASEAN strategy on Kampuchean problem, including denial of economic assistance to Vietnam.
-- Should spotlight illegal use of chemical and biological weapons in Southeast Asia and Afghanistan by Soviets and proxies.

Other Issues (LOS, Nuclear Non-Proliferation, Terrorism). As these issues arise, we should urge the others to stick with us in the LOS negotiations and to sign (France, FRG, UK) the Reciprocating States Agreement as soon as possible.

-- We can improve benefits to Western interests if we are united in demands for improvements to LOS Treaty. Believe that G-77 will eventually realize that a modified treaty with Western participation is only viable alternative.
-- In meantime, we must sign Reciprocating States Agreement to give industry basis for planning deep seabed operations.
-- This Administration is committed strongly to non-proliferation.
-- Especially concerned about nuclear exports to volatile Middle East and South Asia. Believe all exporters should exercise restraint and caution on such transfers.
-- Combating international terrorism remains a major priority. Need to work together.

SOVIET UNION

I. ISSUE

The Allies will be interested in our intentions on a Summit with Brezhnev. Some may voice reservations about our insistence on linking Soviet international behavior to arms control and other aspects of East-West detente. The Soviet succession may also come up.

II. ESSENTIAL FACTS

The President raised the possibility of a meeting with Brezhnev on April 5, in announcing his plans to attend the UN Special Session on Disarmament in June. He drew a distinction between an informal meeting in the event Brezhnev attended the SSOD, and a full-fledged Summit. Brezhnev countered on April 17 with a proposal for a full-fledged Summit in October at a neutral European site. The Soviets have hinted informally that Brezhnev will almost certainly not come to New York. On the succession, the leading candidates are long-time Brezhnev aide Konstantin Chernenko and KGB Chief Yuri Andropov.

III. TALKING POINTS

Criticism: The U.S. is avoiding a serious dialogue with Moscow, and is playing politics with the prospect of a Summit.

Response:

-- We are committed to serious dialogue with USSR at all levels. I've had extensive correspondence with Brezhnev; Secretary Haig has had numerous exchanges, including two meetings with Gromyko.

-- Summit would be of value only if carefully prepared. At same time, my proposal for an informal meeting with Brezhnev was serious, and I regret he was unable to take up the offer.

Criticism: We shouldn't link Soviet international behavior to arms control. Limiting nuclear weapons is of overarching importance.

Response:

-- We do not make any simplistic linkage between arms control and Soviet behavior. Our policies on INF and START reflect our strong commitment to meaningful arms reductions.

-- We have told Soviets, however, that arms agreements and expanded East-West cooperation will lack a durable political base unless accompanied by Soviet restraint and more responsible behavior in regional conflicts. Regrettably, few signs of Soviet restraint.

Criticism: U.S. policies of confrontation with the USSR could bring harder-line forces to power in Moscow after Brezhnev.

Response:

-- We do not seek confrontation, but more stable and constructive relations based on restraint and respect for other's interests.

-- Brezhnev's likely successors have been long associated with his policies, and will be anxious to present united front abroad and at home. So several years of "Brezhnevism without Brezhnev" likely.

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FORMAT ?

SECRET

OVERVIEW: POLAND

I. U.S. OBJECTIVES AND INITIATIVES

Principal U.S. Objective

The top U.S. priority is to seek continued Allied support for the sanctions imposed on the Polish and Soviet regimes in the wake of Warsaw's declaration of martial law until the three conditions agreed to by NATO and the EC are met fully.

Supplementary Objectives

Other U.S. objectives include:

--securing agreement on the need for continued coordination on policies for dealing with the Polish debt question.

--continuing to push for Western participation in formulating a "carrot" in the form of an aid program for Poland should Jaruzelski fulfill the three conditions.

--emphasizing the importance of mutual actions that show the world's headlines.

II. BACKGROUND AND PRE-SUMMIT PREPARATION

NATO and the EC agreed to impose sanctions on the USSR and Poland as a result of Warsaw's declaration of martial law. Since these actions, we have been in close touch with our European friends and allies, and they have agreed to maintain the sanctions until the Polish government meets the criteria of lifting martial law, releasing the detainees, and reopening a dialogue with the Church and Solidarity.

III. OTHER COUNTRY OBJECTIVES AND STANCE ON U.S. OBJECTIVES

While supporting us on the overall question of sanctions, the Europeans have differed with us in two areas; retroactivity and extraterritoriality. They strongly resisted making the sanctions we introduced on December 29 against the Soviets retroactive and they also resist application of U.S. sanctions to U.S.-owned subsidiaries outside U.S. borders (i.e., in Europe).

SECRET

IV. DISCUSSION OF OBJECTIVES

1. Continuation of Western sanctions

--The sanctions we have imposed are clearly having an impact on Poland.

--To be fully effective, however, it is important that we keep the heat on until our three criteria have been met.

2. The Polish Debt Question

--The U.S. position on rescheduling of Poland's 1982 debt is unchanged. We refuse to discuss rescheduling with the Poles until they move to meet our three political conditions.

--The U.S. has no intention of calling Poland in default, media speculation to the contrary notwithstanding.

3. Western Aid to Poland

--To maximize the effectiveness of our sanctions we must hold out the option of additional aid to Poland once they meet our three criteria.

4. Keeping Poland Alive

--The Soviets, and the Polish military regime, are biding their time expecting us to become tired with the Polish issue.

--It is therefore vital that we continue to keep the heat on them by using every possible occasion to make it clear that the future of Poland is very important for all of us.

AFGHANISTAN

I. ISSUE

Afghanistan has been a central issue in East-West relations ever since the Soviet invasion in December 1979. Our policy is directed at bringing the Soviets around to serious negotiations for a solution involving troop withdrawal.

II. ESSENTIAL FACTS

The military situation is essentially one of stalemate. The Soviets have, however, recently increased troop levels (to about 100,000) and have become more aggressive in their use of indiscriminate firepower and massive retaliation against Afghan noncombattants. Their policy of attrition and intimidation has so far failed to dent the strength of the resistance.

The Summit countries are in basic agreement on Afghanistan. They have been active in the diplomatic search for a solution (the EC initiative for a two-stage conference is still on the table). They, like us, accept the present UN negotiating process, the next step in which is indirect discussions in mid-June between the Paks and the Kabul regime, with the UN SYG's personal representative acting as intermediary. Like us they continue to be concerned that the UN effort neither lend legitimacy to the Kabul regime nor undermine the terms of the three UNGA resolutions. The Summit countries agreed last year on the imposition of sanctions against Afghanistan because of its egregious behavior during a 1981 PIA hijacking.

III. TALKING POINTS

There are very few points of divergence among us on Afghanistan. One may be related to the sanctions imposed under the 1978 Bonn antihijacking declaration.

US Point: Ariana Afghan Airlines may be attempting to get new landing rights in Europe after December 1 to take the place of Frankfurt, Paris and London. We have heard they are approaching the Netherlands. We should urge The Hague not to grant these rights.

Retort: Several Summit countries may mention that the US, after pushing for imposition of sanctions, continues to grant Ariana personnel visas for training here.

US Point: For the safety of the US aircraft Ariana owns, we have allowed Ariana personnel to enter for training. Because of the action of Bonn Declaration parties, that policy is now under review.

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KEY ISSUE - THE MIDDLE EAST

I. ISSUE - Future of Camp David Peace Process

-- Attention is now focusing on how to continue the peace process and achieve autonomy for the Palestinians in the occupied territories. Our allies are likely to urge US pressure on Israel to achieve autonomy as soon as possible.

Our allies are critical of Israeli intentions toward the Palestinians and are skeptical about autonomy. Many believe that US pressure is the only way to avert possible Israeli moves to annex the West Bank. Direct pressure tactics would be counterproductive and would hinder the achievement of our other objectives toward Israel. Active US diplomacy will be needed, and we need united allied support for the autonomy talks to ensure their success. The EC Middle East Initiative has been dormant but we think it may now revive after the return of Sinai.

Criticism: Recent Israeli actions give little assurance they intend to grant meaningful autonomy to the Palestinians.

Response:-- We have no reason to doubt repeated Israeli assurances that they will adhere to Camp David and work to achieve full autonomy just as they worked to achieve peace with Egypt.

Criticism: Camp David seems to have reached a dead end --isn't it time to consider other initiatives ?

Response: Egypt, Israel and the United States are committed to pursuing an agreement on autonomy. With Sinai withdrawal completed, parties can now concentrate more fully on this issue. Camp David remains the only framework for peace to which Israel has agreed and offers the hope of real autonomy for the Palestinians during a transitional period.

II. ISSUE - European Relations with Libya

While sharing our concern about Qadhafi's support for international terrorism and subversion, the Europeans prefer to try to influence Qadhafi through diplomatic dialogue rather than imposing economic sanctions. We have strongly discouraged visits by Qadhafi to Europe, and we expect the Europeans not to offset our economic measures against Libya.

Criticism: US exaggerates Libyan threat and risks driving Qadhafi to the Soviets.

Response: US policy has been a measured response to Qadhafi's widespread and continuing support for terrorism and subversion. We do not seek confrontations, but we will not ignore the threat. The Europeans should do nothing to relieve the pressure on Qadhafi until there has been a fundamental and enduring change in his behavior.

LEBANON

I. ISSUES

It is of paramount importance that the cease-fire along the Lebanon-Israel border be maintained and strengthened. We will thus need support regularly from capitals to supplement our diplomatic efforts to prevent PLO activities from Lebanon which violate the arrangement, as well as to urge restraint on Israel in responding to incidents (e.g., strictly within the West Bank and Gaza) that do not violate the cease-fire.

The U.S. continues its firm support of the legitimate central government of Lebanon. We believe it is critical to Lebanon's future that the Presidential election proceed free from external pressure in accordance with Lebanon's well-established constitutional processes.

II. ESSENTIAL FACTS

The Europeans have been responsive to our requests for assistance with the Syrians and PLO regarding the need to avoid provocative actions. The Europeans remain concerned, however, over perceived U.S. inability to prevent Israel from taking actions threatening to the Arabs. We have had to reconcile our concern over such Israeli actions with our central goal of achieving a final Sinai withdrawal.

III. TALKING POINTS

Criticism: The PLO has shown restraint and responsibility in adhering to the cease-fire, particularly following Israeli airstrikes. We are disappointed that the U.S. has not been able to prevent Israel from undertaking a series of anti-Arab actions.

Response:

-- We appreciate your help in persuading the PLO and Israel to avoid actions that could lead to a breakdown in the cease-fire.

-- You can be sure we will continue our efforts to ensure that Israel and others involved in the cease-fire will act with utmost restraint. We welcome your support of these efforts.

CONFIDENTIAL

SOUTHEAST ASIA

I. ISSUE

Necessity for the industrialized countries to continue support for the ASEAN strategy on Kampuchea, including diplomatic isolation and denial of economic assistance to Vietnam.

II. ESSENTIAL FACTS

Vietnamese occupation of Kampuchea is a key concern in Asia. This occupation is a constant source of regional instability -- threatening our ASEAN friends, sharpening Sino-Vietnamese tensions and allowing the Soviets to barter their support for Hanoi into access to air and naval bases in Vietnam. The EC, Japan, Canada and the U.S. have supported ASEAN's Kampuchea strategy, including economic, diplomatic and military pressure to induce the Vietnamese to negotiate a political settlement. The ASEANs and ourselves have been concerned about signs of some weakening European support, especially French resumption of aid to Vietnam and interest in playing a mediating role.

Our Southeast Asia policy has been rooted in support for ASEAN, and it has the lead in dealing with the Kampuchea problem. We oppose any aid gestures to Vietnam, which would only encourage Hanoi to believe its opposition is faltering, and thereby prolong the Kampuchea conflict. We agree with ASEAN that continued seating of Democratic Kampuchea in the UN forestalls recognition of Vietnam's Kampuchea puppets.

III. TALKING POINTS

Criticism: The increased Soviet presence is the principal threat in Southeast Asia. We must offer the Vietnamese an alternative to dependence on the Soviets.

Response:

-- We believe it important to continue to back the ASEAN strategy for dealing with Kampuchea problem.

-- We see no signs the Vietnamese are ready to negotiate seriously on Kampuchea. Unilateral concessions or inducements will only convince Hanoi its opposition is faltering.

Criiticism: Support for Democratic Kampuchea in the UN is an obstacle to a political settlement and an affront to human rights.

Response:

-- ASEAN position on Democratic Kampuchea seating in the UN, which we support, is based solely on need to block seating of the Vietnamese-installed puppet regime.

-- We believe empty seat formula would inevitably lead to seating of Vietnam's puppets.

-- We oppose return to power of Pol Pot regime.

CONFIDENTIAL

Law of the Sea

I. ISSUE:

The Third United Nations Conference on the Law of the Sea concluded its eleventh and final session on April 30, 1982. The United States participated in the eleventh session in hopes of achieving a comprehensive treaty on the law of the sea that incorporated your six objectives for improving the deep seabed mining portion of the Draft Convention. An interagency task force is currently reviewing the convention to determine whether it can recommend that the US become a signatory to the treaty.

II. ESSENTIAL FACTS

After an eleven-month, interagency review of the Draft Convention on the Law of the Sea, you announced on January 29 your decision to resume United States participation in the Law of the Sea Conference. You indicated that you were committed to the multilateral treaty process for reaching agreement on the law of the sea, but that major elements of the deep seabed mining regime in the Draft Convention were unacceptable in that they did not protect our national interests. In addition, you noted six broad areas in which improvement was needed so as to enable you to sign the treaty and actively support ratification by the US Senate.

During this last Conference session, the United States delegation made every effort to cooperate with other delegations and to be receptive to alternatives to our proposals, consistent with your objectives. No substantive negotiations took place on our proposals until the final weeks of the session. The US and other industrialized nations worked closely together at the Conference due to their commonality of purpose in achieving an acceptable, comprehensive Law of the Sea Treaty.

III. TALKING POINTS:

CRITICISM: -- Will the United States sign the LOS treaty?

RESPONSE:

-- The US has been committed to the multilateral process for seeking agreement on the Law of the Sea. Our hope was that a comprehensive treaty acceptable to all nations could be achieved.

-- Going into this last session, we felt that while most provisions of the Draft Convention were acceptable, many elements of the deep seabed mining portion of the Draft Convention were unacceptable. We are actively reviewing the outcome of the last session to determine whether we can accept the final text.

-- We set forth six objectives to correct these unacceptable elements. The US was flexible in how these objectives could be achieved and was willing to and did consider alternatives to its proposals, and in fact accepted alternatives which were consistent with these objectives.

-- The US has greatly appreciated the support and constructive efforts of the Law of the Sea delegations of other western industrialized nations.

II C

INTERNATIONAL TERRORISM

I. ISSUE

International Terrorism remains a serious international problem requiring enhanced cooperation among Summit countries.

II. ESSENTIAL FACTS

Terrorism represents a growing menace to democratic stability and peaceful change.

Attacks against diplomats and government officials have reached alarming proportions and are a threat to world order.

The US will be initiating a new program of anti-terrorism training and assistance at the end of this year designed to help needy governments cope with the terrorism threat in their countries.

Some states such as Libya and Cuba bear a particular responsibility for supporting international terrorism.

III. TALKING POINTS

-- International Terrorism is a problem that affects the world community.

-- All states must adopt a firm no-concession policy to terrorist blackmail.

-- International Terrorism requires an international response - cooperation among like-minded states is essential.

-- More can and should be done in the context of the Summit Seven to enhance cooperation.

-- The successful release of General Dozier by the Italian government was an important victory in the fight against terrorism.

-- States that support international terrorism should be made to pay an international price.

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NUCLEAR NON-PROLIFERATION

I. ISSUE

To impress upon Summit leaders the importance we place on the need to prevent the spread of nuclear weapons, and the need for cooperation among industrial nations to achieve that objective.

II. ESSENTIAL FACTS

We have stressed to the Europeans and Japanese our intention to be a reliable supplier and partner in peaceful nuclear cooperation. At the same time, we need their cooperation in observing restraint in the transfer of sensitive nuclear technologies to unstable regions, in improving the international system of export controls on nuclear trade, and in broadening and strengthening the International Atomic Energy Agency's system of safeguards. France, and to some extent Germany, with large stakes in international nuclear trade, have been skeptical of some U.S. non-proliferation initiatives.

III. TALKING POINTS

-- AS A MATTER OF NATIONAL SECURITY, WE CONSIDER IT VITALLY IMPORTANT TO DO WHATEVER WE CAN TO PREVENT THE FURTHER SPREAD OF NUCLEAR WEAPONS.

-- NUCLEAR TRADE AND COOPERATION ARE ESSENTIAL TO THE ENERGY SECURITY OF MANY NATIONS; WE ARE FIRMLY COMMITTED TO BE A RELIABLE TRADING PARTNER WITH OUR ALLIES IN THIS FIELD.

-- AT THE SAME TIME, WE MUST BE CONSCIOUS OF THE DANGERS OF NUCLEAR PROLIFERATION, PARTICULARLY IN UNSTABLE REGIONS OF THE WORLD.

-- I ASK YOUR COOPERATION IN OBSERVING RESTRAINT IN NUCLEAR TRADE WHICH MAY PRESENT PROLIFERATION RISKS, AND IN IMPROVING THE INSTITUTIONAL FRAMEWORK OF SAFEGUARDS AND NUCLEAR EXPORT CONTROLS.

BILATERAL ISSUES : CANADA

I. STATE OF RELATIONS

Our relations with Canada are close and productive. Canada's approach to world problems is significantly different from that of European countries or Japan, and is closer to our own than that of any other Summit participant. This substantial measure of agreement on international issues is sometimes partially obscured by Canada's desire to preserve an independent course or play an intermediary role, particularly on North-South issues. Bilaterally, our major problems are Canadian treatment of US investment and Canadian concern about acid rain. Financing for the Alaska Gas Pipeline also remains a problem.

II. KEY ISSUES

Canada enacted in December 1981 unfair energy legislation that takes for the Canadian Government a 25% interest in existing oil and gas discoveries on federal land, without paying adequate compensation. That law and several pending bills contain a number of discriminatory measures affecting US energy companies in Canada. Canada has also been attempting to force US firms in Canada to follow "Buy Canada" policies, thereby diminishing the value of trade concessions we have negotiated with Canada. Canada asserts that the high percentage of foreign ownership of industry in Canada makes it necessary for the government to impose controls to ensure that investment is beneficial to Canada and also to pursue "Canadianization" objectives. We believe that foreign investment has made a major contribution to Canada's development and that discriminatory measures are unwarranted and contrary to international norms. It would be helpful to remind Trudeau of our concerns about unfair treatment of US investment in Canada, and to note that we are taking up these measures in the appropriate international fora -- the GATT and the OECD.

Canada is dissatisfied with the progress we are making in our negotiations toward an agreement on transboundary air pollution, under the Memorandum of Intent of August 1980. Canada is pressing us to begin action now to further limit air pollution. While Canada is critical of our efforts, it

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has only recently announced stricter domestic standards that will not become fully effective until 1990. The number of Canadian lakes suffering from acidification is a major political issue in Canada, and one that Canadian leaders and the Canadian public tend to blame on the US. Given the disparity in size of the two countries, we generate most of the sulfur dioxide and nitrogen dioxide emissions in North America. Strong political pressures in Canada could cause the Canadians to break off negotiations with us, unless they can see some indication we are moving toward agreement on a cooperative approach to reduce transboundary air pollution in North America. It will be important to give Trudeau a sympathetic hearing on this topic, while holding to our basic position that expensive new control programs are not warranted without a better scientific understanding of acid rain and how it could be controlled.

The passage by the US Congress of several waivers in December 1981 fulfilled our commitments to Canada on the Alaska natural gas pipeline, but construction of the pipeline continues to be delayed by the inability of the sponsors to complete a financing package. Trudeau has a major political stake in the completion of the pipeline, because of his decision to allow the Canadian southern portions of the pipeline to be built before construction of the US portion was assured. Canada will suffer a major loss of industrial benefits and employment if the project is not built. Trudeau may urge you to make a public statement of support for the project, or perhaps make a private approach to the interested companies. Both Governments have recently expressed their strong support for the pipeline in an exchange of letters at the Foreign Minister level. The letters were released to the press at Canadian Government request. It will be important to convey our continued support for the Alaska Gas Pipeline, while being sure that Trudeau understands that US Government financial support or guarantees cannot be expected, as our commitment is to a pipeline that is privately financed.

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BILATERAL ISSUES: FEDERAL REPUBLIC OF GERMANY

I. STATE OF RELATIONS

Since Chancellor Schmidt's visit to Washington in January, disagreements over East-West policy, economic issues and some Third World questions have become somewhat less contentious, at least in public. Chancellor Schmidt has moved FRG policy in our direction on the Polish issue, continues firmly to support the stationing of intermediate range nuclear forces failing a negotiated solution in the Geneva talks, and has recently refrained in large part from public airing of his concerns about high U.S. interest rates. The President's visit to Bonn and Berlin will demonstrate U.S. commitment to Germany and allow the FRG to reaffirm its close ties with the United States. The President's proposed speech at the Special Session on Disarmament at the U.N. in June, as well as Chancellor Schmidt's appearance there, will contribute significantly to diffusing public criticism of a lack of progress on arms control issues. At the same time, the recently signed Wartime Host Nation Support Agreement clearly demonstrated to the Soviet Union that the U.S. and FRG, in the event of crisis, will cooperate fully in defense of the Alliance.

Differences, however, remain between us and the FRG. Chancellor Schmidt is expected to endorse East-West detente in Versailles and the FRG has been extremely wary of our efforts to limit credit and credit guarantees to the Soviet Union. Some Germans view the credit restriction initiative as a U.S. effort to engage in economic warfare and cut off all trade with the Soviets. Nevertheless, progress is being made in developing a Western consensus on credit restrictions. Also of concern to the FRG are continued high U.S. interest rates which Schmidt asserts are in part responsible for FRG domestic economic difficulties. He also wrote the President in February explaining his efforts to establish a jobs program in order to battle growing unemployment. We have often reiterated that high interest rates in the FRG are not solely caused by high U.S. interest rates, an argument which is recognized but not fully accepted by the Germans.

II. KEY ISSUES

East-West Relations. The FRG has supported our policy in Poland and continues humanitarian aid. However, differences on the overall approach to East-West relations remain unresolved. Schmidt (and the majority of Germans) continue to endorse

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East-West detente which has benefited the FRG in closer relations with the German Democratic Republic, human contacts, and economically. Close East-West ties have also, in the FRG view, contributed to political stability in Central Europe. U.S. export controls in response to the situation in Poland have caught exports related to the construction of the Siberian-West European Pipeline Project. We have also initiated discussions with the Allies on limiting credits to the Soviet Union and have begun to work toward a Western consensus. The issue is complicated because the Germans offer no official credits to the Soviet Union and would view serious restrictions on Hermes credit guarantees as both undermining their competitive position in East-West trade and destabilizing East-West relations. Overall, the FRG believes there is insufficient U.S. understanding for the FRG's East-West policy.

Western Defense and Arms Control. Schmidt has repeatedly stressed his commitment to the NATO dual decision and to INF deployment by Fall of 1983 if INF talks do not succeed. In the April SPD National Convention in Munich, Schmidt reiterated these strong statements and opposed a nuclear freeze as undermining the U.S. negotiating position with the Soviets. Our efforts have been directed toward supporting Schmidt in maintaining his position. We have also made efforts to explain through Schmidt to the German public the realities of the situation in Geneva.

The initiation of the Strategic Arms Reduction Talks has been and continues to be of great importance in the bilateral relationship. As we progress in the preparation of these talks, we need to keep the FRG closely informed.

On conventional defense we have recently signed an agreement with the FRG on Wartime Host Nation Support. This Agreement allows for rapid deployment of U.S. forces with FRG support in wartime and sent the helpful signal to the Soviet Union, which they correctly caught, that the FRG is firmly anchored in the West and is willing to defend the Alliance. We continue to discuss with the FRG NATO-agreed goals for enhancing Alliance defense.

World Economic Situation. Chancellor Schmidt has on a number of occasions expressed his deep concern over the possible strategic consequences of continued economic decline in the West. The success of the President's economic recovery program and the end of recession have been, and will continue to be, key subjects for discussion between the U.S. and FRG.

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BILATERAL ISSUES: FRANCE

I. STATE OF RELATIONS

US relations with the Mitterrand administration are generally excellent. While the French are always eager to reaffirm their independence, our dialogue with Mitterrand, his government and the Socialist Party has been remarkably friendly and relatively open. Our interests run parallel on most essential issues including East-West relations and Western security, the Middle East and Africa. We have disagreements with France on various economic policies and Third World issues, particularly Central America.

II. KEY ISSUES

Mitterrand's government solidly backs NATO's two-track decision, and has reaffirmed its commitment to a strong independent defense force. Mitterrand intends to have France continue to spend over 4 percent of GDP on defense, supports COCOM, the US defense budget, and wants improved defense cooperation with the US and the FRG. We want to reassure Mitterrand of our continued commitment to a strong defense and to meaningful arms control negotiations with the USSR.

Mitterrand does not think economic pressures can change Soviet behavior and claims economic sanctions will be ineffective, provocative and divisive, particularly in times of high unemployment and social strains. The Yamal pipeline contract reflects the French belief that trade in non-strategic goods is advantageous to the West. We seek French cooperation organizing a multilateral mechanism to restrain official and officially guaranteed export credits to the Soviet Union. The French argue that US grain sales are inconsistent with our position.

Mitterrand is making a political issue of high US interest rates and our refusal to intervene in foreign exchange markets. He maintains that the current world economic crisis will persist until the US economy is stimulated, interest rates come down, currencies stabilize, world markets in primary materials are reformed, and massive resources are devoted to the developing countries. The French may try to confront us with a united European front at the Summit. Mitterrand, is unlikely to overdo it, however, because he wants a successful Summit. We want to assure him of the Administration's commitment to lower interest rates, and

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to the goals of higher growth with low inflation and low unemployment.

Mitterrand is trying to follow an evenhanded Middle East policy which balances the right of Israel to live in peace within secure recognized and guaranteed borders with the right of the Palestinian people to self-determination and a political entity. Mitterrand supports the Camp David process and sees it as reaching a natural conclusion with the return of the Sinai. Our major concern is that French initiatives support, or at least not hinder, our own efforts. It will be important to learn Mitterrand's thoughts about a future French role in the Middle East and how it relates to the European Community effort there.

France disagrees with US policy in Central America, although French public criticism has been toned down since Mitterrand's Washington visit. Nevertheless, the GOF maintains that a power-sharing solution for El Salvador must be negotiated among all political parties, and that French support for the Sandinistas can influence beneficially Nicaraguan behavior. Paris also hopes to upgrade its relations with Havana. We want to impress on Mitterrand Nicaraguan and Cuban behavior is not moderating in Latin America, and that we do not believe French arms sales, and opening to Havana, will be successful in influencing their policies.

France is now a center of international terrorism and US diplomats have been targets. Lax French policy on terrorism is at the root of the problem. A sharp debate is currently underway within the French government on security law revisions. We are urging the French to tighten their policies on international terrorism.

For political and economic reasons, France urges resumption of the North-South dialogue. They hope for global negotiations and finding ways to stabilize commodities markets and establish an energy loan fund. The French are very concerned by the substantial reduction of US contributions to multilateral banks. Rather than try bilaterally to persuade us to be more forthcoming on these proposals, however, they may seek to develop a unified European position at the Summit on North-South issues. We should reaffirm our belief in the efficacy of our prescription for rapid and sustained global economic growth, and of our intention to support the Third World through programs such as the Caribbean Basin Initiative.

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BILATERAL ISSUES: EUROPEAN COMMUNITY

I. STATE OF RELATIONS

There is considerable tension in current US-EC relations due to recession on both sides of the Atlantic and fear of a trade war over agriculture and steel. The Community remains concerned about what its member states consider the negative effects of high US interest rates on their economies. The EC Commission, headed by President Gaston Thorn, is responsible for consultations with us on trade. (We enjoy a favorable trade balance: $11 billion in 1981.) EC trade concerns with us and Japan, as well as broader economic issues and their political consequences will be uppermost in Thorn's mind. While the Commission has only a limited mandate on sanctions against the Soviet Union, he has been receptive to our views and the Commission has played a positive role.

II. KEY ISSUES

US-EC difficulties on economic issues have revived interest in improving transatlantic consultations. For that reason, Secretary Haig headed a US delegation for talks with Thorn in Brussels last December. These talks were followed by ministerial-level discussions in Washington in February in which Secretaries Baldrige and Block and USTR Brock participated. While these exchanges have not resolved the difficult economic issues, they have led to a clearer high-level understanding of each other's positions and conveyed to the public the importance we attach to managing our economic relations. We have now proposed that Secretary Haig head the US Delegation to the semi-annual US-EC High-Level Consultations (currently conducted by the Under Secretary of State for Economic Affairs). The initial response from the Commission was positive. You should tell Thorn that we believe the current situation in US-EC relations calls for enhancing our consultative process, and that our proposal to raise consultations to ministerial level reflects the Administration's firm commitment to constructive transatlantic dialogue.

Agricultural trade issues could undermine the US-EC relationship and threaten the GATT system. EC threats to negotiated terms of access to the EC market for US corn gluten feed, and possibly soybeans, and unfair competition in third markets from excessively subsidized EC exports have become highly sensitive political issues in the US. However, the EC sees its Common Agriculture Policy (CAP) as a pillar of European unity and consistent with its international obligations. Reform of the CAP that would reduce its cost and impact on other agricultural exporters has been blocked by internal political pressures from European producer groups, and tensions between the Commission and the member states. Because bilateral talks have not resolved our problems, we have brought a number of GATT challenges, which will put the GATT system to a difficult test. A major US goal at the November GATT Ministerial will be to make progress toward greater liberalization of trade by strengthening GATT coverage of agricultural trade, particularly to limit export subsidies (which the EC will oppose). It will be important to advise Thorn that we look to the Commission to press member states for meaningful CAP reform and to reaffirm to him the importance we place on strengthening GATT coverage of agricultural trade to redeem the promise of trade liberalization.

US-EC relations are also strained by the decision by the US Steel industry to file antidumping, countervailing duty (CVD) and Section 301 actions (based on alleged European subsidization) against imports of European steel. The US market has been important to EC producers, who sold over $2 billion worth of steel here in 1981. The EC steel industry suffers from overcapacity, with utilization rates, employment and profits down sharply. In such a climate, the EC restructuring program has been difficult to implement. EC countries affected by these actions and cases are Belgium, France, Italy, Luxembourg, the Netherlands, the UK and West Germany. Thorn is likely to press you hard for a negotiated, "political" solution to the cases, which are nearing completion. You have very little flexibility under the law to resolve these cases, and the Administration will be sued by the US industry if they are settled for political reasons, or if the very tough statutes under which the cases are processed are not followed to the letter. We need to impress upon Thorn the dangers of our not proceeding in strict accordance with US law, while assuring him that our handling of the cases will not be influenced by protectionist pressures. Each case will be handled on its merits. Meanwhile, Thorn should press ahead to limit subsidization of steel production in Europe.

Europeans are concerned with US macroeconomic policies. To a large extent, our policies are being used to deflect attention from domestic European policies. However, many European leaders are genuinely concerned that our approach is causing US interest rates to be unnecessarily high. They argue that high US interest rates are weakening their currencies and forcing them to follow excessively restrictive economic policies which postpone economic recovery. You should tell Thorn that the US is aware of European concerns, that the Administration favors lower interest rates, and that we are pursuing policies designed to achieve that result. You should also remind him that depreciation of European currencies and high interest rates in some European countries are largely the result of Europe's own economic policies and performance.

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April 22, 1982

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JAPAN

all caps

Economic Background :

Japanese real GNP rose 2.9% in 1981, and is projected to rise by a more modest 2.3% in 1982. Economic performance in 1982 is likely to be characterized by firming domestic demand and far less buoyant external performance than had been previously expected. Inflation could ease to 3% in 1982 (4Q/4Q), down from 4.4% in 1981. The trade surplus should widen slightly from $20 billion in 1981 to $21 billion in 1982, and the current account surplus from $4.7 to $6.5 billion; external performance will be influenced by slow growth in Japan's trading partners and export restraint.

The Japanese government would like to stimulate economic growth, but feels constrained in the pursuit of this objective. Japanese fiscal policy is currently oriented towards reduction of large budget deficits. The Suzuki government is politically committed to achieving medium term reductions in the deficit, but this commitment is probably already unattainable. In JFY 1981 (April 1981-March 1982) the deficit as a percentage of GNP was around 5 percent. The JFY 1982 budget seeks to reduce the deficit to around 4% of GNP, primarily by restricting the growth in nominal expenditures to 6.2%, the smallest increase in 26 years. Japanese authorities have gradually relaxed monetary policy, but have been reluctant to cut official interest rates because of fears that further declines in Japanese interest rates might augment capital outflow from Japan and weaken the yen, enhancing Japan's export competitiveness, trade frictions, and suspicion Japan purposely maintains an artificially low yen. Real wage growth has been moderate, and this trend is likely to continue, in particular because of low wage increases in smaller and medium sized enterprises. Japanese authorities feel that it is mainly through declining inflation that they can boost real consumption. However, inflation is already low, and will not likely show further sharp deceleration.

The Japanese financial system is not fully open to foreign participation; credit is rationed by official moral suasion; and the government allocates a large amount of preferential credit to industry and to inefficient sectors. These financial policies keep Japanese interest rates below market clearing levels; thereby providing subsidized financing to Japanese industry and contributing to a bias towards capital outflow. Japan also denies foreign imports equitable access in the Japanese market, particularly in the agricultural sector which provides the electoral base for the ruling Liberal Democratic Party. Japan's failure to achieve full import and financial liberalization has perpetuated the economy's strutural bias towards external versus domestic led growth.

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The Japanese yen has been extremely weak over the last year. Japanese authorities have expressed concern that the weakness of the yen is not justified by Japan's relatively favorable economic performance. The Japanese largely attribute yen weakness to capital outflow, caused by high U.S. interest rates. The authorities have intervened in the exchange market, at times forcefully, to slow yen depreciation, and have asked the U.S. to join Japan in coordinated intervention operations. Japan has implemented capital controls to stem capital outflow -- cutting back on foreign security placements in the Japanese market and banning Japanese purchases of certain dollar-denominated instruments.

Bilateral Japanese trade with the Soviet Union represents about 2% of Japanese exports and 1% of Japanese imports; from 1974-1978, almost half of Japan's exports to the Soviets were official credit transactions. Total Japanese official credit and guarantee exposure to the Soviet Union is approximately $3.6 billion. Japanese lending to the Soviet Union has slowed in recent years because Japan decided to review credits to the Soviet Union on a case-by-case basis after the Afghanistan invasion; and the interest rate permitted Japan under the OECD export credit arrangement is higher than that for commercial credit so there is no incentive to seek official export credits. Japan has indicated willingness to limit credit to the Soviet Union along the lines of a Western position, after such a position is successfully coordinated among the other Western allies.

Treasury: IMA

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JAPAN
Key Statistics
(Percent changes; Billions of dollars)

	1978	1979	1980	1981	1982 (to date)	1982F	1983F
Real Growth Rates (s.a.a.r.) 2/							
GNP	5.1	5.6	4.2	2.9	—	2.3	5.5
Private Consumption	4.7	6.2	1.3	0.6	—	2.4	4.2
Private Plant & Equipment Invest.	18.3	12.5	6.5	1.6	—	3.7	4.2
Government Consumption	5.1	4.0	2.1	3.6	—	2.9	2.4
Industrial Production	6.2	8.3	7.0	3.1	-2.4 (Jan)	4.0	5.6
Unemployment Rate	2.2	2.1	2.0	2.2	—	2.1	2.1
Inflation 2/							
Consumer Price Change	3.8	3.6	8.0	4.9	0.4(Mar)	3.2	4.3
Wholesale Price Change	-2.5	7.3	17.8	1.6	0.8(Feb)	1.5	2.2
Balance of Payments (s.a. $bill)							
Trade Balance	$24.6	$1.8	-$ 2.1	$20.0	$3.2(Feb)4/	$21.0	31.8
Current Balance	$16.5	-$8.7	-$10.7	$ 4.7	$0.8(Feb)4/	$ 6.5	16.0
Money Supply Growth s.a.							
M2 + CDs 3/ 5/	13.1	9.1	7.2	10.5	10.7 (Feb)		
Interest Rates							
Short-term 6/	4.6	8.1	9.5	6.6	7.2(Apr 16)		
Long-term	6.7	8.6	9.2	8.6	8.4(Apr 16)		
Exchange Rate Change (%) 3/							
vis-a-vis dollar	+23.3	-23.2	+18.1	-7.7	-11.4(Apr 16)		
trade-weighted (OECD)	+19.7	-24.6	+17.3	-3.2	-8.1(Apr 14)		

1/ Forecast updated December 1981
2/ Period average; for 1982, latest 3 months over previous 3 months, at compound annual rate.
3/ Dec/Dec; for 1982 M2+CDs, from target period through month indicated.
4/ Cumulative.
5/ M2+CDs includes cash, demand deposits, time deposits and CDs.
6/ Unconditional call money, end of period.

Ralph V. Korp
X
Declassification on 4/21/88

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Treasury Department
April 21, 1982

cy EUR/RPE

4/22/82

UNITED KINGDOM

Economic Background: Inflation in the UK slowed substantially to 11.8% after reaching 18% in 1980. The outlook is for some further decline, with a sustained single digit inflation rate towards year-end. Moderation in wage increases and productivity increases in the latter half of 1981 have sharply reduced the rise in unit wage costs. Progress on reducing inflation has also been aided by falling petroleum prices, wholesale prices and mortgage rates as well as smaller excise tax increases. The unemployment rate continued rising during 1981, reaching 11.5% at year-end. No early progress for a significant fall in the unemployment rate is likely. Real GDP in 1981 was 2.7% below the 1980 level but the recession bottomed out in the second quarter of the year and growth was positive in the second half. Real GDP growth for 1982 is forecast at about 1.5%, with the main basis for recovery to be the swing in inventories. The current account was about $16.4 billion in surplus in 1981 due primarily to a depressed demand for imports and higher North Sea oil and gas revenues. The current account surplus is expected to be cut at least in half in 1982.

The Government has attempted to restrain public expenditure and borrowing to provide scope for private sector expansion. These goals have been frustrated by a recession which was longer and deeper than originally expected. The ratio of general government expenditure to GDP has in fact increased over the past few years to an estimated 46% in FY82. The tax burden has also increased. The public sector borrowing requirement (PSBR) rose from 5% of GDP in FY80 to over 6% in FY81. For FY82 the PSBR is estimated to have been below the target at about 4% of GDP (equivalent to a U.S. budget deficit of $146 billion). The PSBR for FY83 is to be held to 3.5% of GDP.

Under Thatcher, total public expenditures in real terms have risen due to increased costs of unemployment benefits (up almost 90% from FY80 to almost 1% of GDP in FY82); aid to industry (up 42% from FY80); and higher defense spending (up 5% from FY80). Thus, rather than reduce the size of govenment, there has been an increase in real government spending. Transfer payments for social security, health and unemployment have increased about 11% (in real terms) from FY80 to FY82. Even eliminating the increase in unemployment costs, other social transfers grew by almost 8% in real terms from FY80 to FY82.

The Government originally set its monetary targets in terms of £M3. Target growth rates for £M3 have, however, been exceeded by substantial margins. In the first 14 months of the government's Medium Term Financial Strategy (MTFS) an annual target growth range of 7-11% was set for £M3. The actual annual growth rate of £M3 over the first year was almost 20%. In the second year of the MTFS the range was shifted to 6-10%, but actual £M3 growth was above the top range of the target. In both years other aggregates -- the monetary base and M1 -- grew moderately (in FY81 the monetary base grew at an annual rate of 7.5% and M1 grew at 5.5%.) In the March 1982 budget, a specific monetary target for £M3 was dropped in favor of a single upward revised range (8-12%) for £M3, M1 and M3. The upward trend growth implied by this vague target does not allow the favorable expectation effects of a clearly announced and pursued non-inflationary monetary policy to operate.

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The Thatcher Government has attempted to create an environment which encourages private investment. Many of the fiscal subsidies and regional assistance programs have, however, frustrated the process of structural change and maintained or prolonged inefficiencies. Currently, subsidies, grants and other transfers make up about 40% of total public expenditure. Regional and industrial assistance programs alone took up about 45% of the total expenditures of the Department of Industry in FY82 and represented about 1% of total government expenditures. These expenditures have remained stable throughout the Thatcher Administration.

The government also provides assistance to nationalized industries and publicly-owned companies. Many of these entities have been operating under substantial losses, under conditions of overmanning and low productivity. Government subsidies for the nationalized industries have increased under the Thatcher Government. In FY80 government lending to nationalized industries accounted for about 1.5% of total central government spending. By FY81 lending to nationalized industries climbed to 3.5% of total central government expenditure.

One factor distorting the efficient allocation of resources in the labor market has been the large and increasing transfers to the unemployed. From FY76 to FY82 unemployment benefits have increased by over 50% in real terms. These transfers now amount to about 1/2% of GDP. Rigidities in the labor market have prevented the downward adjustment of real wages toward levels that would provide incentives to hiring labor. The results have been workers priced out of jobs, overmanning in some industries and a curtailment of new investment.

Intervention to bolster the exchange rate artificially has not taken place to a significant extent. The Bank does intervene in an effort to smooth out what it considers disruptive fluctuations in exchange rates. There are now no controls in the UK on capital transfers, exchange transactions or gold transactions. The exchange rate is viewed by many as an indicator of domestic monetary conditions. On occasion, however, monetary policy has been directed toward supporting the exchange rate by raising domestic interest rates.

Trade with the USSR accounts for just over 1% of UK's total trade. Available information indicates a decline in exports to the USSR during 1981. UK-East European trade relations are also modest. Exports to East European countries accounted for 1% of total British trade in 1980. British trade has focused primarily on Poland, which accounted for 40% of East European imports and 47% of exports in 1980.

The UK's official exposure in the USSR was $1.6 billion as of September 1981. Exposure in Eastern Europe was $35 billion in the same period ($2 billion was in Poland). Outstanding claims of UK registered banks including branches and subsidiaries worldwide on the USSR were $3 billion at the end of June 1981. Claims on Eastern Europe were $9.9 billion (about $2 billion on Poland and $3.5 billion on the GDR).

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Key Statistics
(Percentage Changes or Billions of Dollars)

	1979	1980	1981	1982 (To date)	1982 1/	1983 1/
Real Growth Rates (s.a.) 2/						
GDP (output measure)	1.7	-2.8	-2.8	0.9 1/	1.5	2.0
Private Consumption	4.0	0.1	0.0		0.5	1.5
Government Consumption	1.8	2.1	0.3		1.0	1.0
Gross Domestic Fixed Investment	-1.4	-0.6	-7.5		1.0	5.0
Industrial Production	2.7	-6.6	-5.0	-0.5 (Jan)	3.3	2.0
Unemployment Rate 3/	5.4	8.8	11.5 (Dec)	11.8 (Mar)		
Inflation 2/						
Retail Prices	13.4	18.0	11.9	11.5 (Jan-Feb)	9.0	7.9
Wholesale Prices (output)	12.2	16.3	10.5	10.6 (Jan-Mar)	9.7	8.4
Average Earnings	15.5	20.7	12.9	10.5 (Jan-Mar)	9.8	10
Balance of Payments (s.a.)						
Trade Balance	-7.0	2.8		0.3 (Jan)		
Oil Balance	-1.7	0.7	5.5	0.3 (Jan)	5.5	7.4
Current Balance	-1.8	7.1	16.4	0.7 (Jan)	7.3	7.1
Fiscal Balance (PSBR as % of GDP) 6/	-5.0	-6.6	-4.3		-3.5	-2.8
Money Supply Growth Rate (s.a.) 3/						
M1, 7/	10.1	5.9	8.5 (Dec) 9/	8.8 (Feb)		
Sterling M3 8/	13.4	19.7	15.5 (Dec)	14.5 (Feb)		
Monetary Base 5/	11.5	5.3	3.5 (Dec)	3.4 (Feb)		
Treasury Bill (91 days) Yield 3/	16.5	13.0	14.6 (Dec 18)			
Exchange Rate Change (%) 4/						
vis-a-vis dollar	9.3	6.9	-25.0	-5.3 (Mar)		
trade-weighted vs. other G-8	7.7	14.5	- 9.5	-0.9 (Mar)		

1/ Forecast updated April 1982
2/ Period average over same period year before
3/ End Period or 12-month rate
4/ Since December preceding year
5/ Currency in circulation plus banks' deposits at the Bank of England
6/ Fiscal years
7/ Currency in circulation plus sterling demand deposits.
8/ M1 plus sterling time deposits.
9/ Annual rate since February 1981 base

Classified by Ralph V. Korp
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Declassification on 4/22/88

Treasury Department
April 22, 1982

CONFIDENTIAL

4/22/82

ITALY

cy EVR/RPE

Economic Background

The Italian economy is expected to experience a weak recovery in 1982, following a recession during 1981. The economy is shackled by high inflation, an external deficit and a very large budget deficit. 1982 GDP growth is forecast to average 1.0 percent, as exports grow moderately, but domestic demand remains flat. The cost-of-living index is forecast to rise 16.5 percent, well above the average for Italy's trading partners. Wage gains, spurred by wage indexing, are again likely to outpace inflation. Unemployment reached 9.1 percent in fourth quarter 1981 and is likely to move higher in 1982. The current account deficit is forecast to narrow to $4.5 billion in 1982 from $8.0 billion in 1981, remaining in deficit for a third year despite stagnant domestic demand.

Fiscal policy is very expansionary and unlikely to become significantly less so in 1982. The deficit of the expanded public sector was equivalent to 13.4 percent of GDP in 1981 (including off-budget items and transfers to local governments and the many public sector enterprises). For 1982, the parliament has approved a deficit ceiling equivalent to 11 percent of GDP, which we consider unattainable. There are strong political pressures to restore cuts announced by the government in health and other social expenditures, and the government's deficit estimates appear based on overly optimistic economic assumptions. Revenues have increased more rapidly than GDP in recent years, due to higher VAT taxation, reduced tax evasion and "bracket creep", but a succession of weak governments have allowed expenditures to expand even more rapidly and the share of the public sector in the economy has been growing.

Monetary policy, which is oriented mainly toward protecting Italy's external position, began tightening late in 1979 and is now clearly restrictive. M1 increased 9.9 percent and M2 increased 9.8 percent during 1981, as the public shifted funds out of banks into higher-yielding Treasury securities. Interest rates rose 4 percentage points during 1981 to the 20-23 percent range, and since then have come down only slightly, remaining positive in real terms. Monetary aggregate growth is not targeted. Instead, the authorities target domestic credit growth, relying heavily on credit controls and deposit requirements to achieve these targets in the face of heavy public sector borrowing. Even so, Total Domestic Credit* increased 18.6 percent during 1981, above the year's target of 16 percent, as public financing needs were

* Total Domestic Credit = The public sector domestic borrowing requirement, plus most domestic lending to the private sector (commercial bank, bonds, and medium-term loans by the State's special credit institutions).

higher than anticipated. In July 1981, the requirement that the Bank of Italy buy up all unsold Treasury securities was ended, opening the possibility of a shift toward greater reliance on market forces in the future. Monetary base (excluding postal deposits) increased 12.6 percent during 1981.

Adjustment of the Italian economy to changing world trading realities has proceeded slowly in recent years. Government intervention in the economy to override market mechanisms and allocate resources is extensive. The authorities have often delayed increases in administered prices, such as of oil products, electricity and telephone service. Ailing public sector enterprises have been required to retain redundant workers and inefficient plant and equipment. Rigid labor laws have also made layoffs difficult in the private sector. Wage indexing is widespread in Italy. Indexing occurs quarterly, with these wage increases covering about 80 percent of increases in consumer prices.

Italy is a member of the European Monetary System. Exchange rate policy emphasizes protecting competitiveness in the medium-term. During 1981, the lira's EMS central rate was devalued twice -- by 6 percent in March and by 3 percent in October -- sufficient to protect competitiveness in major European export markets. Competitiveness improved in the U.S. and OPEC markets, as the lira depreciated by 29 percent against the dollar. Recent strong Italian intervention in support of the lira reflects mainly the unwinding of an exchange deposit requirement which was ended in February, but there is nevertheless widespread anticipation of a further EMS realignment involving the lira later this year.

Italian exports to the Soviet Union and Eastern Europe totalled $3 billion in 1980, about 4 percent of total exports. Half of this amount went to the Soviet Union. Italian imports from the Soviet Union alone in 1980 totalled $3 billion. Imports from the East have consistently exceeded exports, and to bolster exports Italy has generously provided subsidized export credits.

Italy

Key Statistics
(Percentage Changes or Billions of Dollars)

	1978	1979	1980	1981	1982 (To-date)	1982F 1/
Real Growth Rates (s.a.) 2/						
GDP	2.6	5.0	4.0	-0.2	—	1.0
Private Consumption	2.9	5.4	4.4	0.2	—	0.6
Public Consumption	1.8	2.1	2.0	1.8	—	1.7
Gross Fixed Investment	-0.1	5.8	10.0	-0.2	—	-5.5
Industrial Production	1.9	6.6	5.6	-3.5	-3.0 (Jan-Feb) 3/	
Unemployment Rate	7.2	7.7	7.6	8.4		9-1/2
Inflation 2/						
Cost-of-living	12.4	15.7	21.1	18.7	16.7 (Jan-Mar) 3/	16.5
Wholesale Prices	8.4	15.5	20.0	16.6	17.4 (Jan-Feb) 3/	15.0
Wage Rate Per Man 5/	16.1	18.6	21.3	23.1	—	—
Balance of Payments						
Trade Balance (fob/fob)	2.9	-1.0	-16.3	-10.4	—	-8.2
Oil Balance		-10.8	-18.9	-20.5	—	-19.3
Current Balance	6.2	5.2	-9.7	-8.0	—	-4.5
"Expanded Public Sector" Borrowing Requirement (as % of GDP)	15.6	12.3	12.1	13.4	—	11 (target)
Money Supply Growth 4/						
M1	26.4	23.5	12.9	9.9	—	—
Interest Rates: Interbank	11.5	11.9	17.2	19.6	20.1 (Jan)	—
Govt Long-Term Bonds	13.7	14.1	16.1	20.6	21.1 (Jan)	—
Exchange Rate Change (%)						
vis-a-vis dollar	+5.0	+3.2	-15.3	-29.4	-7.1 (Thru Mar)	
trade-weighted	-2.2	+2.3	-5.5	-11	-1.7 (Thru Mar)	

1/ Forecast last updated April 1982.
2/ Period average
3/ Percentage change over corresponding period
4/ End period, 12-month rate
5/ Contractual hourly wage in industry.
F= Forecasts

OASIA:IMA
April 22, 1982

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(entire text)

4/23/82
cy EUR/RPE

GERMANY

Economic Background

Real GNP showed little growth in 1981. On average real output was 0.3 percent below the 1981 level, but grew over the course of the year to the fourth quarter by 0.8 percent. The only significantly growing component of demand was export volume, which rose more than 6 percent, aided by a sharp boost in German trade competitiveness from low inflation and a lower DM. We expect a mild but steady upswing over the next year, with exports again the major growth factor. Real GNP is forecast to grow 1.3 percent in the year to 4Q82, and 1 percent over 1981 on a year average basis. Somewhat more rapid growth is expected in 1983, with output rising 3.6 percent in the year to 4Q83, and 2.2 percent on average over 1982. Fixed investment should contribute importantly to the 1983 real output acceleration. But only in the second half of 1983 is the growth pickup expected to be great enough to reduce unemployment in the face of productivity increases and labor force growth. The unemployment rate was 7.1 percent (s.a.), or about 1.7 million persons, in March 1982, the highest rate since the end of postwar reconstruction.

Continued reduction in inflation rates is expected over the next two years. Consumer prices rose 6.0 percent in 1981 and are forecast to rise 4.9 percent in 1982 and 3.8 percent in 1983. Recent key wage settlements have been in the 4 percent range; declining dollar oil and raw material prices should also make a contribution. However the likely rebuilding of the eroded profit share of GNP means that prices will not decelerate as rapidly as unit labor costs.

In 1981 the current account deficit declined 40 percent in DM terms, or from $16 billion in 1980 to $7.7 billion in 1981. A small surplus was posted in the fourth quarter, the first since 1Q79. This improvement is due to a major strengthening in the German competitive position (with a 14 percent fall in the real DM exchange rate from December 1978 to January 1982), continued substantial reductions in oil consumption (down 11 percent in 1981) and a general drop in import volume due to the weak level of domestic demand. The service account deficit has been rising, owing to rising interest payments on both private and official external borrowing. We expect continued improvement in the current account, with a surplus of about $2 billion in 1982 and $8 billion in 1983.

Fiscal policy is tightening somewhat in 1982, but monetary growth is likely to be somewhat greater than in 1981. In the year to 4Q81 M1 fell 1.8 percent as monetary growth was below the targeted lower end of the 4-7 percent growth range in Central Bank Money which remains the target for 1982, but is intended to be attained in the upper rather than lower end of the range. In the first quarter of 1982 responding to improved inflationary prospects and complementary to the encouraging trend of moderate wage settlements, the Bundesbank has twice cut the key money market rate by half a point to 9.5 percent.

Treasury:OASIA/IMA:Oscar M. Mackour

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U.S. - GERMAN ECONOMIC FACT SHEET

	U.S.	Germany
Unemployment Rate (March)	9.0 %	7.1 %
Inflation Rate (CPI)		
1980 (12 months to December)	12.4 %	5.5 %
1981 (12 months to December)	8.9 %	6.3 %
Latest month (annual rate)	-3.3(Mar)	0.0(Mar)
Money Supply		
M-1 Growth Rate (Q4-80 to Q4-81)	5.0 %	-1.8 %
Real GNP Growth (1981)	+2.0 %	-0.3 %
Interest Rates (short-term) 2/		
Nominal		
March 1981	14.4 %	13.3 %
March 1982	14.2	9.8
Real (adjusted for inflation)		
March 1981	+5.1 %	+7.2 %
March 1982 (Estimated)	+11.1	+6.3
Central Government Budgets		
Deficit		
($ bil)		1/
1981	-58	-18 (-77)
1982	-100	-14 (-60)
As % of GNP		
1981	-2.0 %	-2.4 %
1982	-3.2 %	-2.0 %
Expenditures		
Growth rate		
1981	+14 %	9 %
1982	+10	5 %
As % of GNP		
1981	23 %	16 %
Balance of Payments (Current Account)		
($ bil)		1/
1981 (Estimated)	+6.6	-7.6 (-32)
1982 (Projected)	0	+1.6 (+7)

1/ For comparison, German data in parentheses adjusted to larger size of U.S. economy.
2/ U.S. rate: 90-day N.Y. CDs; German rate: 3-month Interbank.

cy EUR/RPE

4/22/82

FRANCE
Economic Background

Higher consumption, brought about by increases in social transfers and wages, is expected to support the recovery that began in mid-1981. GDP growth was estimated at 0.7 percent in 1981 and is projected to average about 2.7 percent, annual rate, during 1982-83. Although investment improved in the fourth quarter of 1981, surveys of investment intentions remain pessimistic. Doubts about the durability of the recovery and rising labor costs are offsetting the prospect of higher sales and substantial government (through the nationalized firms) investment. Notwithstanding various measures providing direct investment incentives and inducements to "share" jobs, the unemployment rate is likely to keep rising at least through 1982.

The consumer price index started slowing in the closing months of 1981, perhaps because of selective price controls and limitations on public utility and other administered price increases, but rising wages and demand will likely stimulate attempts to restore profit margins. We expect inflation to re-accelerate by the end of 1982, continuing in 1983. A rapidly expanding budget deficit, far beyond what the domestic bond market can accommodate, seems to assure an acceleration in money supply growth and thereby render the maintenance of exchange rate stability within the EMS quite unlikely. Speculation against the franc flared up in March, and another devaluation will probably be required in the next few months. The trade deficit will likely worsen as a consequence of the relatively faster growth and higher inflation in France than in its trading partners. The deficit could reach about $15 billion in 1983. At that point the French government may have no other choice but to rejoin the mainstream of U.S. and other OECD country economic policies.

The Mitterrand Government's main economic objective is to reduce employment by expanding demand. (It views policies in other countries, particularly in the United States, as giving too much importance to fighting inflation and producing excessively high interest rates and excessive demand restraint.)

Fiscal policy is oriented toward stimulating economic expansion via increases in social transfers, support for employment and investment, and aid to ailing industries. The increase in government expenditure is only partly offset by revenue increases, coming mainly from increased taxes on higher incomes. The government fiscal balance, which was in slight surplus in 1980, shifted into substantial deficit in 1981 and is projected to continue worsening through 1983 to about 4.3 percent of GDP. This attempt to expand demand and output through increased government outlays is undermining confidence and will probably produce higher prices and imports rather than more real growth. Higher taxes and social security contributions on business (together with various other measures, see below) will depress investment, which will worsen unemployment.

Monetary and credit policy objectives are dominated by the need to meet the government's increasing borrowing requirements. Bond issues are subject to queueing and bank credit to quantitative controls with the effect of generally rationing credit to the private sector and redistributing it to the government. Monetary growth depends primarily on the size of the budget deficit, since the Bank of France, either directly or indirectly, is a major source of financing for the government. The monetary growth target was shifted up to the 12.5-13.5 percent range for 1982 (a reversal of the declining trend under the preceding government), but, given how the budget deficit is likely to be financed, even this objective is likely to be exceeded.

The Mitterrand Government aims at keeping the nominal exchange rate as stable as possible, but, because of lack of market confidence in its basic policies, has been forced to rely increasingly on intervention and exchange controls in addition to its traditional weapon of interest rate increases. The French view the dollar appreciation as an additional source of pressure against the franc because of its worsening effect on France's oil bill and trade deficit; they would like us to intervene to reduce dollar appreciation.

The Mitterrand Government launched a big rise in industrial subsidies, especially for sectors where import penetration had increased sharply (e.g. textiles and capital goods). "Reconquering the domestic market" is a government slogan. Its nationallization program covered the ailing steel industry, 5 large industrial conglomerates, and almost all private banks. Nationalization has raised the share of value added under government control to about 30 percent from 10 percent.

Labor policies have been oriented toward raising the incomes of the lowest paid workers through discretionary increases in the minimum wage and reducing unemployment through various work sharing (or unemployment sharing) measures. The latter include the introduction of a fifth week of paid vacation, a reduction in the work week to 39 from 40 hours (to be further reduced to 35 hours by 1985), and a reduction in the retirement age to 60 from 65 by 1983. These work-sharing measures are expected to raise labor costs since they are generally to be implemented without a cut in pay and are therefore unlikely to be effective in fighting unemployment.

French exports to eastern Europe amount to about $5 billion, or 4 percent of total French exports. As of mid-1981, Soviet and eastern European indebtedness to France was about $10.5 billion.

France

Key Statistics
(Percentage Changes or Billions of Dollars)

	1979	1980	1981	1982 4/	1983 4/	1982 (To-date)
Real Growth Rates (s.a.) 1/						
GDP	3.7	1.3	0.7	2.4	3.2	
Private Consumption	3.6	2.2	2.3	3.0	3.8	
Investment	3.7	2.6	-0.8	1.0	2.9	
Industrial Production	4.7	0.0	-0.8	2.6		1.6 (Jan)
Unemployment Rate (Ave.)	6.1	6.4	7.8	9.0		8.7 (Mar)
Cost of Living 2/	11.8	13.6	14.0	15.0	17.0	14.2 (Mar)
Balance of Payments (s.a.)8/						
Trade Balance (fob/fob)	-2.3	-12.3	-9.0	-11.4	-14.8	
Current Balance	1.2	-7.8	-7.5	-10.0	-13.0	
Fiscal Balance 7/ (% GDP)	-0.1	+1.1	-2.4	-3.8	-4.3	
Money Supply Growth Rate 2/						
M1 5/	12.1	7.0	14.7			
M2 6/	14.4	9.8	11.4	15.	17.	
Interest Rates						
Call money (Ave.)	9.1	11.8	15.5			17.0 (April 15)
Public Sector Bond (Dec.)	12.6	14.3	16.5			16.4 (April 15)
Exchange Rate Change 2/						
vis-a-vis dollar	3.9	-10.9	-20.7			-9.2 (April 16)3/
trade weighted	7.8	-2.3	-14.2			-0.7 (April 16)3/

1/ Period average
2/ End period; 12-month change
3/ From December preceding year
4/ Updated April 1982
5/ Currency in circulation plus demand deposits.
6/ M1 plus time deposits
7/ Includes central government plus social security
8/ Converted at FF6.6/$ in 1982 and FF7.25/$ in 1983.

Treasury Department
April 22, 1982

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April 22, 1982

CANADA

EUR/RPE

Economic Background

Canadian economic activity declined sharply in real terms during the third and fourth quarters last year; recovery is not expected until mid-1982 and growth for the year as a whole may be slightly negative. The 1981 current account deficit of $5.5 billion is forecast to widen to about $7.5 billion this year, due primarily to higher interest payments on Canada's external debt. Inflation may moderate somewhat from the 1981 average of 12.5 percent, but wage rate increases will likely prevent it from falling below double digits. Unemployment is expected to average about 9 percent of the labor force, a post-war record high.

Canadian fiscal policy is supposed to be contractionary over the medium term. The November budget (for FY 1982/83) called for restraining expenditure growth to a rate below that of nominal GNP growth, and forecast a reduction in the $11 billion federal deficit (4 percent of GNP) in FY 1981/1982 to $8.7 billion (2.8 percent of GNP) in FY 1982/1983 due primarily to sharply increased revenues from energy taxes. But a number of factors have conspired in recent months to lower anticipated government revenues substantially, including weaker than forecast economic activity and lower than anticipated energy tax revenues because of soft world oil prices. Expenditures will be higher than planned also, primarily because of larger unemployment compensation payments, and the federal deficit may rise slightly instead of falling. The consolidated public sector deficit, which fell about $3 billion to $1.8 billion last year, may reach $11 billion this year (4.1 percent of GNP), as the Western provinces have reacted to the current recession by adopting expansionary budget policies.

Since 1975, the Bank of Canada's (BOC) stated intention has been to aim at a gradual reduction of the rate of monetary expansion with a view to achieving sustained, non-inflationary, economic growth. The BOC has specified a target range for M1 growth which has been lowered at about yearly intervals; the present range is 4-8 percent annual growth from the quarter centered on September 1980. But the BOC has frequently used interest rate policy to prevent the exchange rate from depreciating when short-term interest rates in the United States moved above those in Canada. In the past two years, this externally oriented policy has had an adverse impact on the stability of M1 growth with respect to its target range. Canadian M1 was below the lower end of the target growth range throughout most of the second half of 1981, and through the first quarter of 1982.

In addition to using interest rate policy to maintain the external value of the Canadian dollar, the BOC has intervened, at times heavily, in the foreign exchange market. The BOC usually intervenes only when the Canadian dollar is under downward pressure, because the Bank is concerned about the potential inflationary consequences of a depreciation. The Canadian dollar has weakened vis-a-vis the dollar since the National Energy Program (NEP) was introduced in October 1980. Over the past 7 months in particular, the market

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appears to be reacting unfavorably to Canada's discriminatory treatment of foreign investors. As long as the BOC maintains its present policy of hiking interest rates to hold the exchange rate, periods of weakness in the Canadian dollar will probably tend to undermine the goal of achieving a monetary target.

Canadian criticism of domestic economic policy revolves around the Trudeau Government's insistence on maintaining a relatively tight fiscal and monetary stance as the Canadian recession deepens. Pressure is mounting for the Government to announce a stimulative mini-budget containing job creation measures. Provincial premiers have suggested that interest rates be lowered and the exchange rate "let go." Rumors of wage and price controls continue to circulate in the press. The Trudeau Government refuses to change its policies aimed at reducing inflation, and is asking public sector workers to moderate demands for wage increases due this year. Indications are that public sector employees, after seeing their real incomes decline for three consecutive years, will not honor the Government's request.

Another major concern of the Trudeau Government is implementing the Canadian National Energy Program (NEP). The NEP was designed to achieve several goals simultaneously: (1) increase Canadian ownership and control of the predominantly foreign-controlled energy sector to assure energy security for Canada; (2) accelerate exploration and production of energy resources on Canada's frontier lands to reach energy self-sufficiency by 1990; (3) claim a larger share of energy revenues for the Federal Government to reduce the deficit; (4) assure that the benefits of higher Canadian participation in energy development spill over into other sectors, particularly manufacturing, via increased purchases of inputs from Canada. To achieve goals (1) and (4), the Canadian Government has adopted various procurement and investment policies which discriminate in favor of Canadian firms. The investment climate in Canada has soured considerably as a result of these policies and as a result of arguably expropriatory provisions in the NEP that have generated a high degree of uncertainty regarding investment in Canada. In 1981, outflows of direct investment capital reached an unprecedented $10 billion and many oil rigs moved south to operate in the United States. Projections for energy investment in 1982 are down sharply as well, due in part to soft world oil prices but also reflecting the lack of investor confidence in Canada. The Trudeau Government, which has staked its reputation on the NEP, is beginning to see the economic costs of "Canadianization."

Canada's economic approach to trade with Eastern Europe is to exploit commercial opportunities not prohibited by NATO or OECD agreements. Canada enjoyed roughly a $1.3 billion trade surplus with Eastern bloc countries in 1980, mainly reflecting large wheat shipments to the U.S.S.R. and Poland. The Canadian Government intends to partially finance the export of sulphur extraction equipment for the Soviet Astrakhan Pipeline if the Soviets decide to purchase from Canada. Eastern Europe's current official indebtedness to Canada is about $1 billion. Private sector lending to these countries is estimated to be $2.4 billion.

Ralph V. Korp
☐ Declassify X
Declassification on 4/22/88

CANADA

Key Statistics

(Percent Changes; Billions of Dollars)

	1979	1980	1981	1982 (to date)	1982 1/	1983 1/
Real Growth Rates (s.a.) 2/						
GNP	3.0	0.0	3.0	—	-0.1	4.9
Private Consumption	2.0	1.0	1.7	—	0.8	3.0
Government Consumption	0.5	-0.5	2.0	—	1.9	1.2
Government Fixed Investment	-5.6	-0.4	1.8	—	1.1	1.0
Private Investment	7.2	4.5	5.9	—	-3.6	6.6
Industrial Production	4.7	-1.6	1.2	—	—	—
Unemployment Rate 2/	7.5	7.4	7.5	9.0 (Mar)	9.2	
Inflation 2/						
Consumer Prices	9.1	10.1	12.5	11.6 (Mar)	10.0	9.3
Industry Selling Prices (output)	14.4	13.4	10.2	6.7 (Jan)	7.8	9.4
Average Earnings	7.0	8.2	11.0	—	—	—
Balance of Payments (s.a.)						
Trade Balance	3.3	6.8	5.4	1.1 (Jan)	6.5	9.9
Oil Imports	4.6	5.8	6.5	—	5.4	5.4
Current Balance	-4.5	-1.3	-5.5	—	-7.5	-6.3
Federal Budget Deficit (% of GDP)	4.2	4.7	4.0	—	3.8	—
Money Supply Growth, s.a. 3/						
M1 4/	7.2	10.7	2.5	-4.0 (Mar)	—	—
M2 5/	17.6	16.0	16.9	11.2 (Mar)	—	—
Short Term Interest Rate	11.6	13.0	18.3	15.7 (Mar)	—	—
Exchange Rate (%) 6/						
vis-a-vis dollar (Dec/Dec)	0.9	-2.3	1.0	-3.0 (Mar)	—	—
Trade-weighted vs. G-7 (Dec/Dec)	1.15	-2.3	2.0	-1.7 (Mar)	—	—

1/ Forecast last updated April 1982.
2/ Period Average
3/ End Period, 12-month rate; to date figure is annualized change from December
4/ Currency and Demand Deposits
5/ Currency and all chequable notice and personal term deposits
6/ Negative change indicates depreciation of Canadian $.
Trade weighted exchange rate is Treasury Department calculation

Classified by: Ralph V. Korp
Review for declassification: 4/21/88

OASIA/IMA
4/21/82

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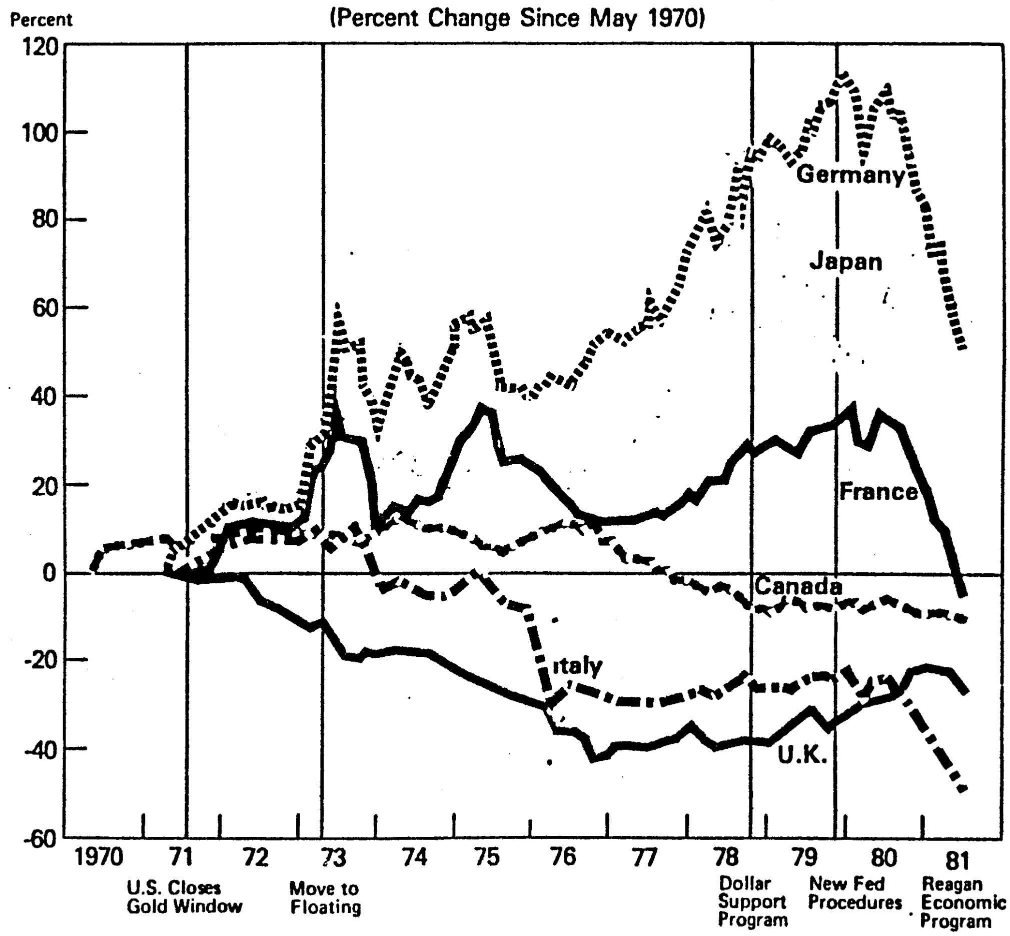
Bilateral Exchange Rates of Summit Countries Against the Dollar

(Percent Change Since May 1970)



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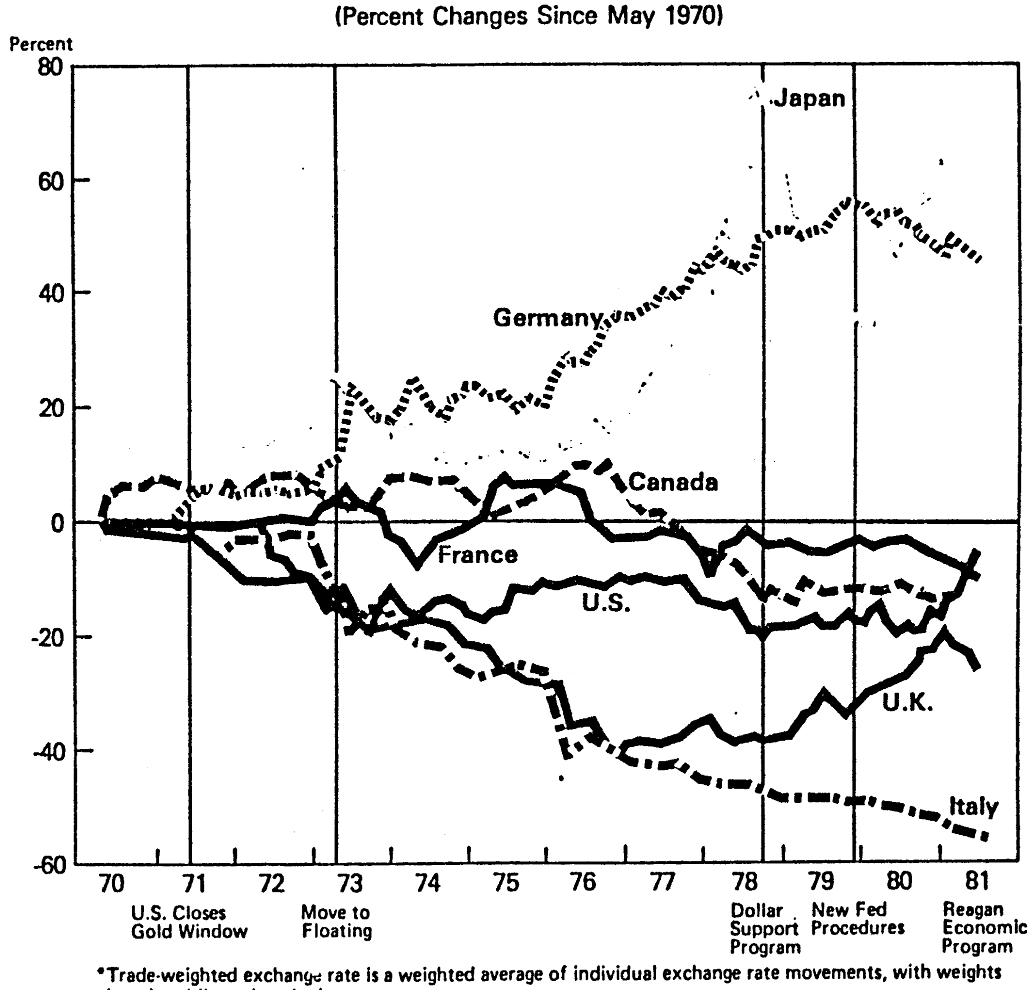
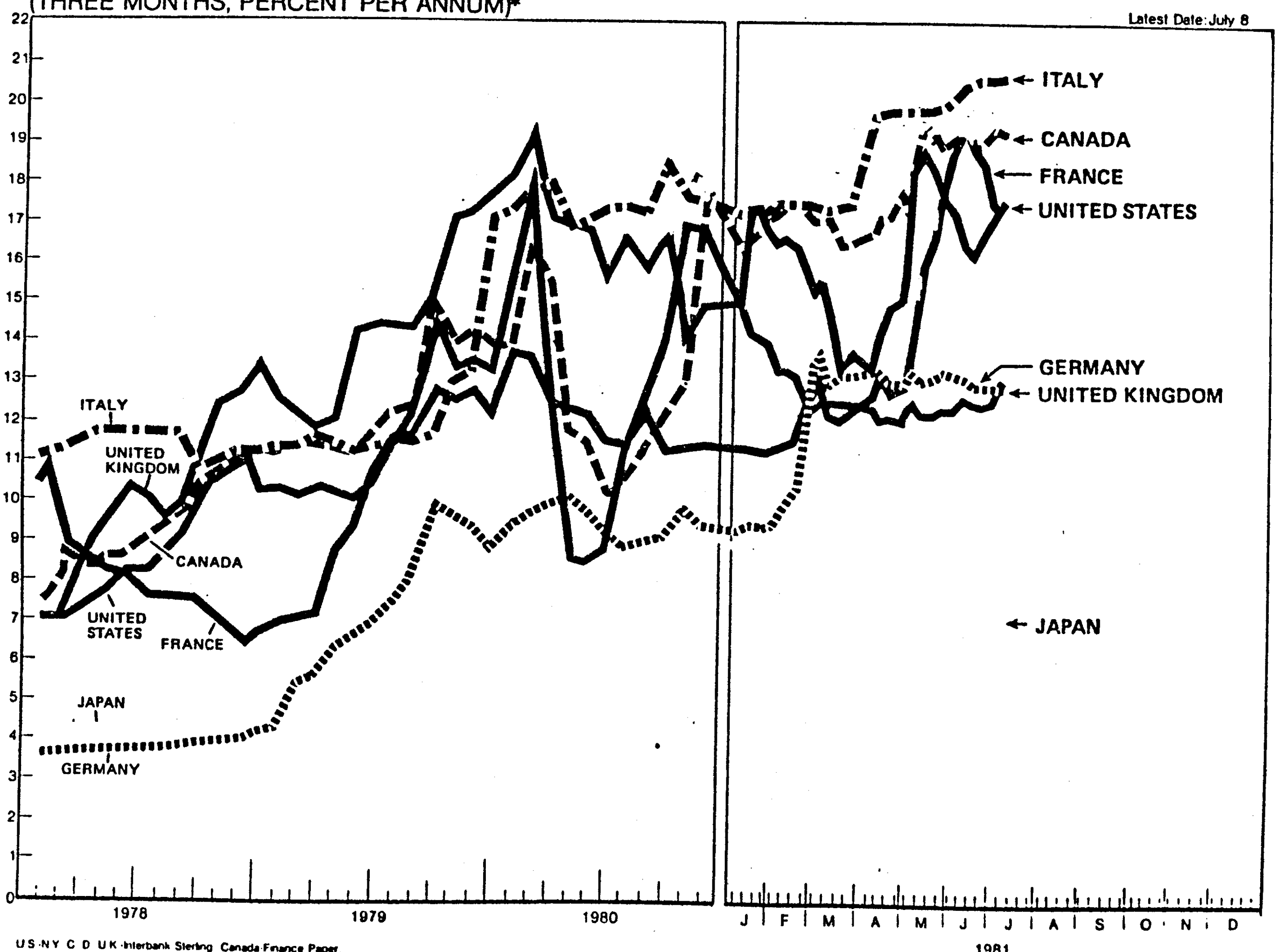
vs. the OECD

(Percent Changes Since May 1970)



*Trade-weighted exchange rate is a weighted average of individual exchange rate movements, with weights based on bilateral trade shares.

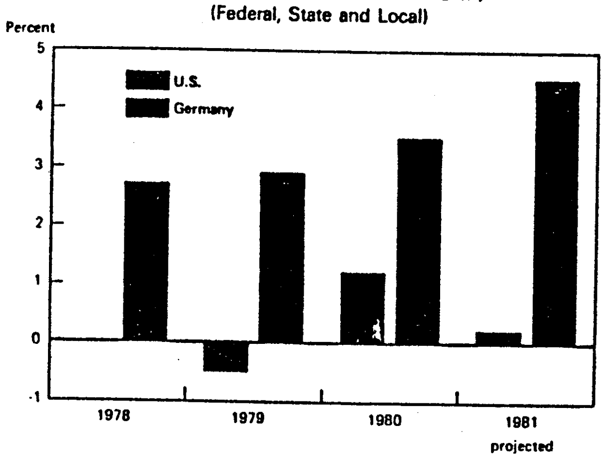
SHORT TERM INTEREST RATES
(THREE MONTHS, PERCENT PER ANNUM)*



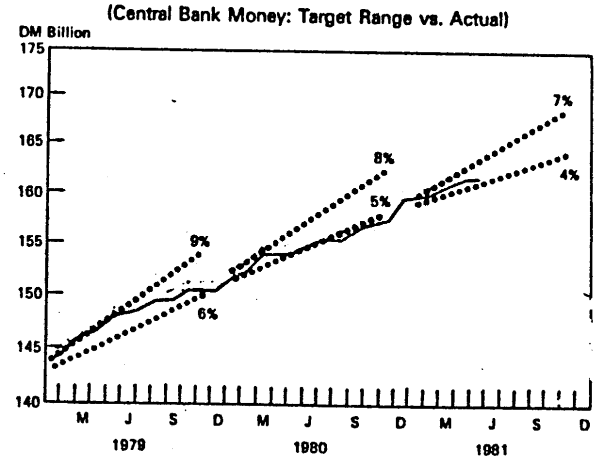
US-NY C D UK-Interbank Sterling Canada-Finance Paper.
France-Paris Money Germany-Frankfurt Money Japan-Unconditional Call; Italy-Milan Money*

Germany: Selected Economic Indicators

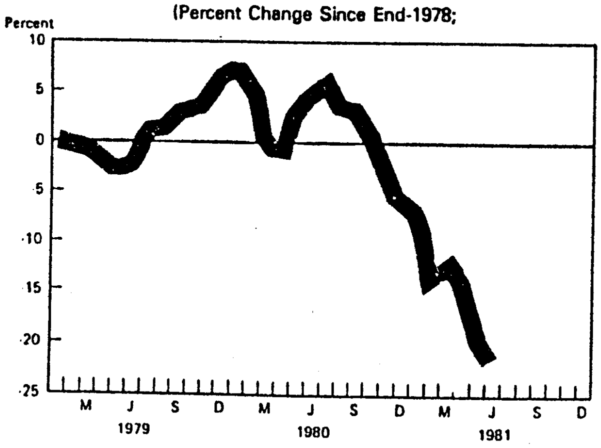
Fiscal Policy
(Government Deficit as Share of GNP)
(Federal, State and Local)



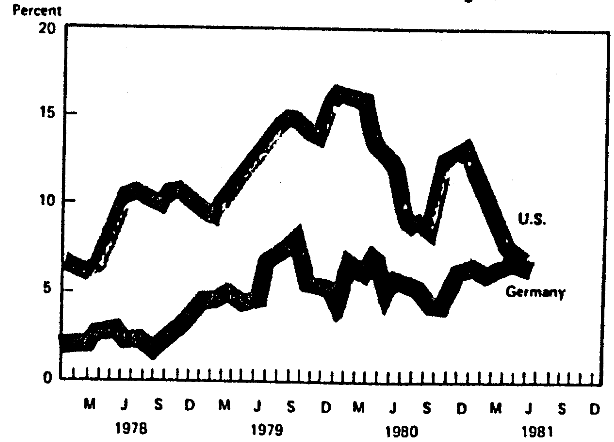
Germany: Money Growth
(Central Bank Money: Target Range vs. Actual)



Exchange Rate: German Mark vs. U.S. Dollar
Plus Indicates Appreciation of German Mark)
(Percent Change Since End-1978;



Inflation Rates
(Consumer Prices: 3-Month Averages)



POLITICAL BACKGROUND : CANADA

I. OVERVIEW

The major political factors that will affect Canada's participation in the Versailles Summit are:

-- declining popular support (31%) for the Trudeau Government, attributable to dissatisfaction with high interest rates, unemployment, and inflation;

-- Trudeau's perceptions of himself and of Canada; and

-- Canada's desire to play an independent international role without falling into unproductive opposition to the US, with which Canada shares a broadly similar world outlook.

Canada's economic problems will make Trudeau cautious about commitments that would expand Canada's budgetary deficit or diminish exports. Trudeau sees himself as the senior Summit participant with a broad understanding of world issues. He sees Canada as an industrial country with special understanding for developing nations, and as a Western nation that nevertheless has an understanding of and a certain entree in the East. This enables Trudeau to see himself as a logical mediator or catalyst on North-South issues, disarmament or other East-West issues. Canada's basic handicap in international diplomacy is that it operates from a relatively insignificant power base. Its initiatives can only prosper with the support of the other members of the Alliance. Moreover, Trudeau's freedom of action is circumscribed by the general similarity of Canada's world outlook to that of the US, and by a traditional Canadian desire to avoid a break with the US on international issues which are inherently of less interest and importance to Canadians than their important bilateral relationship with the US.

II. POLICY PROBLEMS AND CONSTRAINTS

Political imperatives in Canada and the policies of the Trudeau Government point toward a stance for Canada at the Versailles Summit that emphasizes:

-- strong support for an early beginning of arms control talks (START and IMF);

-- public expression of continuing interest by Summit countries in problems of LDC's and in global negotiations;

-- and adherence to the NATO consensus on Alliance issues, while working quietly for NATO decisions that would avoid onerous commitments.

Canada will attempt to promote these objectives in a moderate way, within the bounds set by the overall similarity of its world outlook with that of the US and its desire to work harmoniously with the US on Alliance objectives.

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POLITICAL BACKGROUND: FEDERAL REPUBLIC OF GERMANY

I. OVERVIEW

Chancellor Schmidt, successful in containing the left-wing of his Social Democratic Party (SPD) at the National Convention in Munich, will come to the Summit politically strengthened but still threatened by continued domestic political and economic difficulties. Economic policy differences between the SPD and its Free Democratic (FDP) coalition partners are likely to intensify as the FDP looks toward state elections this year and federal elections in 1984. An SPD defeat in an election in Hamburg on June 6 will raise more doubts regarding the coalition's staying power and Schmidt's future. In security policy, Schmidt won a significant majority for his position supporting the NATO decision on INF, while conceding only the possibility of reconsideration of deployment in late 1983 by the SDP, not necessarily the government.

II. POLICY PROBLEMS AND CONSTRAINTS

The survival of the SPD-FDP coalition until the 1984 election depends in a large part on the resolution of policy differences on key economic, environmental and social legislation. The coalition partners continue to agree on security policy despite efforts of the SPD left-wing to block the implementation of INF deployment. Schmidt and Genscher have a better than even chance to resolve or postpone their differences and maintain their coalition at least until the October 1984 election. Schmidt's victory at the SPD National Convention in Munich in April strengthens his negotiating position with the left-wing of the SPD.

The opposition Christian Democrats (CDU), headed by Helmut Kohl, and their Christian Social (CSU) allies continue to focus their efforts on winning state elections, succeeding in Lower Saxony and facing good prospects in Hamburg, Bavaria, and Hesse with a platform opposing the coalition's jobs creation program and attacking the FRG's growing budget deficit. They have also made a clear effort to project a progressive image, especially towards the youth. On security issues the CDU/CSU basically follows federal government positions and has emphasized its support for the NATO dual track decision on many occasions. The latest public opinion polls show that the CDU/CSU would win were elections held today.

Recent gains by environmentalists and opponents of nuclear arms and nuclear energy have caused some concern in the

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domestic political scene in the FRG. The so-called "Green" movement has gained seats in several state parliaments and is expected to win a significant number of votes in Hamburg (June) and Hesse (September) this year. As a result, there is a growing concern that the major parties will be unable to form coalitions to govern some state governments, a development with serious implications for the national elections in 1984. The "Green" movement, coupled with the peace movement, attracts support from varied groups in Germany, including the churches and youth. Although the Communists have exploited this movement, their machinations have been exposed and the movement remains for the most part an expression of concern on the part of average citizens. We should continue to address these concerns (the environment and arms control) as these groups will continue to have a definite impact on public opinion and political life in the FRG.

POLITICAL BACKGROUND: ITALY

I. OVERVIEW

The Government of Prime Minister Giovanni Spadolini is under increasing pressure and its collapse was barely averted in mid-April. The Italians may well be represented at the summit by an essentially caretaker government, led by Spadolini or someone else, in a pre-electoral political atmosphere. Christian Democrats and Socialists, now and probable future coalition partners, may be contrasting their views more sharply on issues ranging from the Siberian pipeline to Central America. The Italians will be even more alert than usual to the constraints of domestic affairs on their foreign policy considerations. While expressing fundamental agreement with the U.S. on most major summit issues the Italians may be unable to speak with precision and authority.

II. POLICY PROBLEMS AND CONSTRAINTS

Italy has been supportive of the United States on major issues including Afghanistan, Iran, Poland, the Siberian pipeline and the decision to modernize intermediate nuclear forces in Europe. It helped coax its European partners into participation in the Sinai Multinational Force (MFO). The January rescue of General Dozier heightened the close relationship and good feeling. There is little doubt about continued Italian support on the broad policy issues. As the Socialist Defense Minister remarked concerning INF, "we have made our choice. There will be polemics and debates, but the decision has been made."

The Prime Minister may be unable to handle the issues with authority if Socialists and Christian Democrats are castigating one another. The "pause for reflection" on the Siberian pipeline will probably have lapsed and the Italians will have contracted for Soviet gas, but the issue will remain a point of contention between Socialists and Christian Democrats.

The Italian government parties continue to have divergent views on Central America. Christian Democrats will be under pressure to reduce their relationship to El Salvador's Christian Democrats if the latter enter government with the parties of the right. The Socialists maintain sharp criticism of U.S. policy toward El Salvador. Bilateral meetings with the Italians on such issues can produce a useful exchange of views, but effective Italian support is not likely. By contrast, the Italians will be helpful and should go as far as European consensus will permit on East-West, terrorism and the Middle East.

POLITICAL BACKGROUND: FRANCE

I. OVERVIEW

The success of Mitterrand's economic policies will determine the political future of his administration. Mitterrand's program to stimulate the economy and to restructure it along Socialist lines has not reduced unemployment, but it has eroded business confidence and support of the crucial uncommitted "swing vote". Now, Mitterrand has two choices: to steer a more moderate course which could undermine the Left coalition and split the Socialist Party, or to continue the expansionist program and thus ensure leftist unity at the risk of further alienation of the Center.

II. POLICY PROBLEMS AND CONSTRAINTS

Current political problems in France are a direct outcome of the government's policies of rapidly pushing through major portions of the Socialist platform and emphasis on maximum possible economic growth to generate employment. Policy decisions have included: raising the minimum wage to increase consumption, massive public spending and hiring, increased credit for labor intensive industries, nationalization of an important part of industrial capacity and most of the banking system, and labor and social reforms designed to increase employment.

These measures and the way they were implemented have been very costly to the government. They have produced high budget and balance of payment deficits, contributed pressure on the franc, and have been unsuccessful in bringing down or even containing unemployment which is moving upward toward 9 percent, a post-war record.

The pace and manner of adoption of the Socialist reforms and the government's partisan approach to implementation have highlighted divisions in French society and created fears and tensions in the propertied and managerial classes. The reaction to these reforms contributed to the loss of seats by the Socialists, and particularly the Communists, during local elections of March 1982 when much of the uncommitted "swing vote" that supported Mitterrand against Giscard in May 1981, voted for conservative candidates. The vote was also a protest by some voters against the inclusion of Communist ministers in the Mauroy government. The opposition has gained confidence from these elections and is gearing up for the municipal elections next March.

President Mitterrand's economic program has failed to win the support of private business which still controls over half of the economy. Mitterrand has acknowledged this by making tax concessions to French employers, hoping this will induce private investment which has been declining since his election. The Socialist Party is debating whether to slow down or speed up the pace of reforms. A slow down would risk alienating the Socialist left wing and splitting the party which Mitterrand painstakingly constructed and passionately wishes to maintain intact. Even now the Mauroy Government is in trouble, and there are rumors of ministerial changes for early this summer.

Paradoxically, Mitterrand's successful strategy of weakening Communist voting strength has also weakened, overall, the Left. Mitterrand may decide eventually, therefore, he can no longer afford to continue this strategy and consider undertaking a more mutually supportive relationship with the Communists who have already indicated a willingness for greater cooperation. Alternatively, he may seek to distance himself from the Communists if the pact with them promises to be more a liability than an asset in the March 1983 municipal elections.

Mitterrand's choice will depend largely on future French economic performance and could affect US-French relations. Efforts to maintain the unity of the Left could involve decisions that would erode French support on Alliance and Western security issues. France could become more receptive to expanding economic and technical relations with the USSR. Greater deference to left wing Socialists would also increase our differences on Central America.

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BACKGROUND PAPER: UNITED KINGDOM

I. COUNTRY'S PRIORITIES

-- Obtain a NATO Defense Review which would support a reduced British NATO defense role and lower spending.

-- If the Falklands crisis persists, push for a strong NATO blessing for British actions.

II. DOMESTIC SETTING

Prime Minister Margaret Thatcher's Conservative Government is benefiting from the decline in levels of inflation and a slight improvement in the unemployment statistics. Her political prestige has increased with her strong response to the Falkland Islands crisis: polls show that most British voters support her policy of seeking a negotiated solution from a position of strength. Should, however, her Falklands policy fail, her government will fall. The Labor opposition has also supported this policy, and moderates within the party are using the Falklands crisis to discredit the left wing, which has been less bellicose than UK public opinion. There is resentment in the UK over the US "even-handed" policy on the Falklands, although there is no evidence that close defense cooperation with the US has yet been effected.

Elections must be held by May, 1984, but the Prime Minister may call them earlier. Margaret Thatcher's chief potential rival for Prime Minister in her own party is probably Francis Pym, the new Foreign Secretary.

On a per capita basis, Britain has been one of NATO's top spenders on defense. It develops its NATO policy in particularly close concert with our own.

III. US VIEWS

We are opposed to any UK effort to secure a NATO Defense Review. Our view is that it would be essentially an attempt to legitimize HMG doing less in the defense area. (The issue paper on long-term defense programs addresses this issue.)

Aside from general discussions at the Permanent Representative level, we do not believe that NATO is the best place to deal with the Falklands crisis. This is an issue which we are currently working only within a bilateral context.

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Our "special relationship" with Britain is based on extremely close political, military/intelligence, economic and cultural ties. These ties are vital to our security interests in Europe and important to our objectives in most other areas of the world.

Should the South Atlantic crisis continue, and should the US maintain its current "even-handed" policy, HMG's willingness to assist the US in world tasks not clearly and urgently linked to specifically UK national interests will be reduced. Nevertheless, everyone in Britain continues to view the US as the key to Western security and there remains a strong emotional attachment to American cultural and social values.

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JAPAN: POLITICAL BACKGROUND

I. OVERVIEW

Japan approaches the Versailles Summit with an increasing awareness of its status as a world power and the need to make a more positive contribution to common international problems. For Prime Minister Zenko Suzuki, the Summit presents an opportunity to convince a somewhat doubtful Japanese public that he is a statesman capable of representing Japan among the leaders of other major powers. Suzuki's uneven record as Prime Minister has encouraged speculation that he may be replaced as head of the ruling Liberal Democratic Party (LDP) in elections scheduled for this November. However, Suzuki still has widespread support within the LDP and the position of his government is further strengthened by the continued disarray of Japan's opposition parties.

II. PROBLEMS AND CONSTRAINTS

When elected in July of 1980 as president of the LDP -- and thus Prime Minister -- Suzuki was a party veteran respected for his abilities as a consensus- builder, but he had little experience in national or foreign policy issues. His handling of the Diet, particularly in the passage of his controversial administrative reform measures, has been a testimony to his skills as a political negotiator. On the other hand, Suzuki's seemingly indecisive responses to incidents in US-Japan relations raised concern over his ability to manage serious bilateral problems. Japan's current economic slump, moreover, has inevitably affected the popularity of Suzuki's government, and some LDP leaders who want to increase government expenditures are clearly dissatisfied by Suzuki's insistence on fiscal austerity and reform of the GOJ bureaucracies.

While these problems naturally reflect on Suzuki's prospects for re-election as LDP President this November, observers generally agree that his tenure is not in imminent danger. The strong coalition of LDP factions that brought Suzuki to power still stands behind him (if only for want of a truly acceptable alternative) and few LDP politicians can be anxious to risk a resumption of the bitter in-fighting that threatened to undermine the party in the months preceding Suzuki's election.

Both Suzuki and the LDP are further strengthened by the continuing disarray of Japan's opposition parties. Although still the largest of these groups, the Japan Socialist Party (JSP) is torn by ideological disputes and faces a steady erosion of its electoral appeal. The Japan Communist Party (JCP) remains largely isolated from the rest of Japan's political spectrum and depends primarily on its pursuit of such popular domestic issues as pollution, public services, and political corruption for its modest electoral successes. In an effort to rally their forces, both parties have focussed on the disarmament movement and will be heavily represented among the Japanese delegations to SSOD II.

Of greater importance to the future of Japanese politics is the development of moderate opposition parties--the conservative Democratic Socialist Party (DSP), the Buddhist-affiliated Komeito, the LDP splinter New Liberal Club (NLC), and the Socialist-breakaway Social Democratic Federation (SDF). These parties tend to share common interests in close US-Japan ties, moderate economic policies, and a somewhat stronger Japanese defense posture. However, given their inability to resolve differences with each other, let alone the LDP or JSP, the prospects for a viable alternative to LDP rule remain on the horizon, but are for now beyond reach.

Fluctuations in the fortunes of its political parties have, however, little direct effect on Japan's evolution toward a somewhat more assertive foreign policy. Despite continuing reservations over the risks attending a higher profile in world affairs, there is a growing perception among the Japanese that they can and should assume an international role more commensurate with their great economic strength. This can be seen not only in such specific issues as Afghanistan, Poland, refugees, economic aid to countries of strategic concern, and arms control, but in Japan's increasingly conscious identification with the industrial democracies--the very term "western alliance", until recently avoided as too sensitive for Japan's diplomacy, is now widely used in Tokyo. PM Suzuki will thus not only be under pressure to deflect criticism on trade issues at Versailles, but to ensure that Japan is properly represented as a respected member of the industrial democracies. His success in this would do much to bolster his standing within the LDP and among the Japanese public at large.

POLITICAL/ECONOMIC BACKGROUND: EUROPEAN COMMUNITY

I. OVERVIEW

The Community is at a difficult juncture. Its member states are in a recession, short- and mid-term employment prospects are poor and there are increasing trade pressures. These problems are compounded by the related issues of EC budget reform; modifications to the Common Agricultural Policy (CAP), which consumes 70% of EC funds; and the further enlargement of the Community to include Spain and Portugal during this decade. The EC will become an increasingly cohesive entity only if it is able to deal with these challenges.

II. POLICY PROBLEMS AND CONSTRAINTS

The Community has been working intensively on its budget and CAP reforms. However, the member states are pulling in different directions. Little progress has been made on these politically sensitive issues, which affect the very basis of Community cooperation. In addition to being in the middle of the debate among member states on budget/CAP reform, Thorn is under pressure from the European Parliament to produce results on these issues. However, prospects are dim.

More broadly, the Community's internal problems thwart rapid headway on US-EC trade problems. The Commission in recent years has lost the policy initiative. Wide differences of view among member states -- whether for philosophical, political or purely economic reasons -- make significant policy changes unlikely in the near term. However, the Commission has shown its ability to cooperate on certain issues, e.g., export credit and Soviet trade import restrictions, when there is some consensus among member states on basic principles. Further, the very divisions among member states that rule out profound change do leave room for some flexibility by the Commission, using its own considerable administrative authority, to address problems. This situation suggests that a patient, incremental approach in US dealings with the Commission on our shared trade problems is the best approach.

On political issues, the Community, under the direction of the current Belgian Presidency, has continued to assume growing importance in international affairs. The Belgians have done a superb job of conducting the US-EC dialogue, keeping us informed of developments and working US views into the Community consultative process. The EC has taken decisive action in supporting the UK on the Falkland Islands by embargoing Argentine imports to the Community. The EC diplomatic initiative to help find a peaceful solution for the

Mideast -- one of the major sensitive items in US-EC political consultations -- has been kept on a backburner, pending the return of the Sinai. We continue to fear EC activities could undercut our own efforts. EC activity in this area will pick up in the months ahead, and will include visits by Belgium's Foreign Minister Tindemans to the Middle East, before the Belgian Presidency ends on June 30.